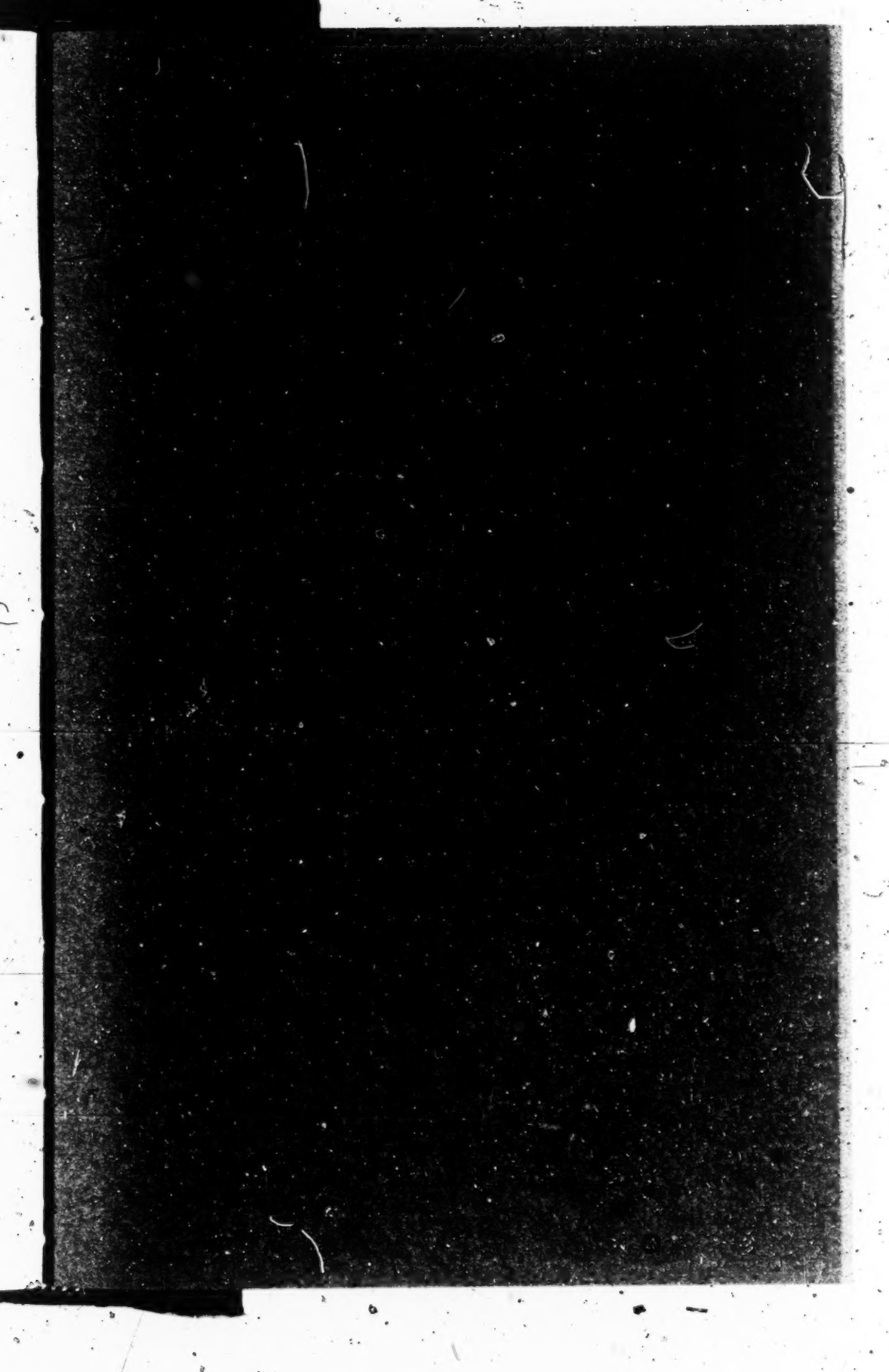

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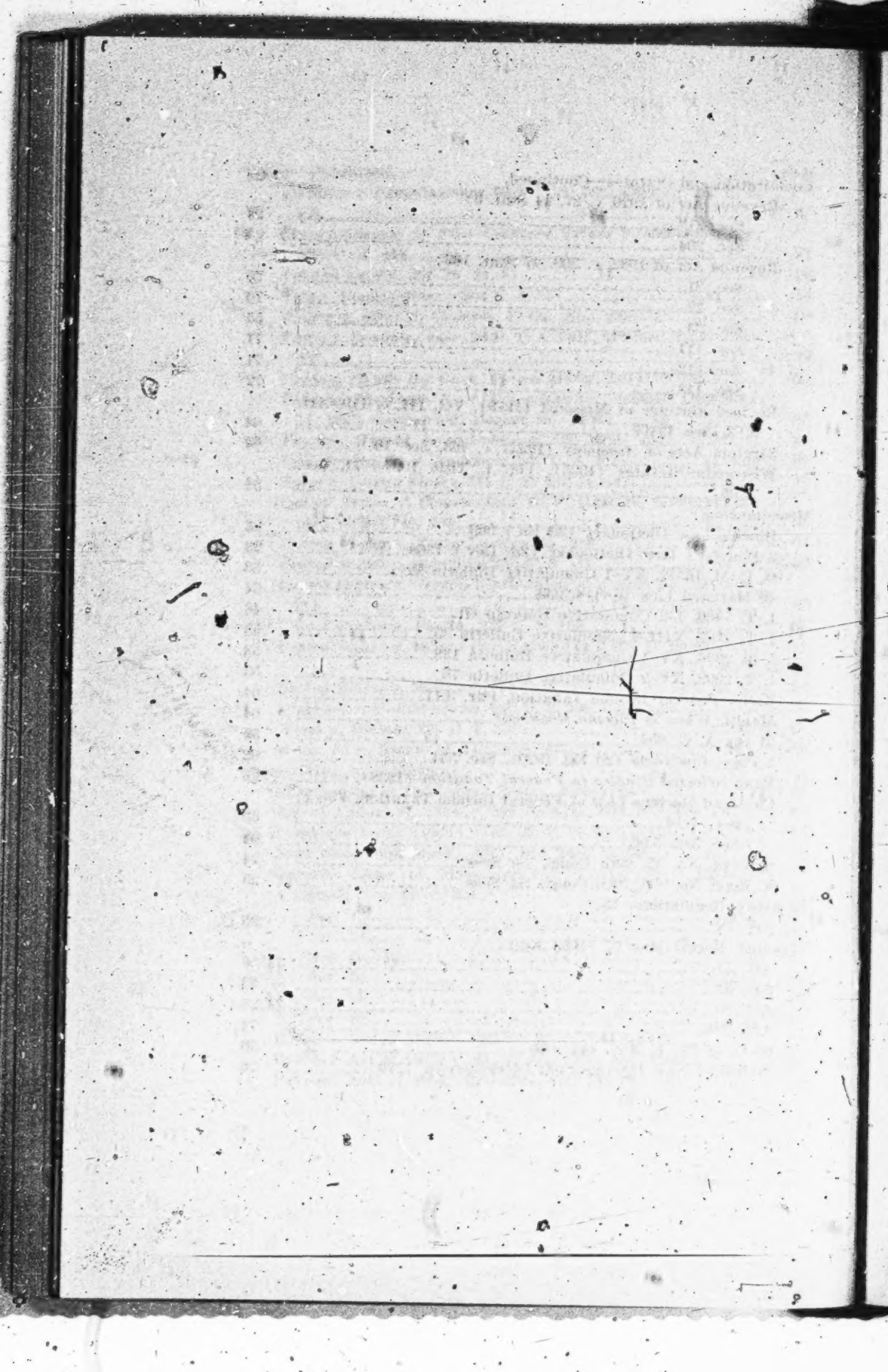

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 48

MUNRO L. LYETH, PETITIONER

v.

JAMES J. HOEY, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 112–117) is reported in 20 F. Supp. 619. The majority opinion of the Circuit Court of Appeals and the concurring opinion of Judge Augustus N. Hand (R. 124–131) are reported in 96 F. (2d) 141.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 18, 1938 (R. 131–132). The pe-

tition for a writ of certiorari was filed May 18, 1938, and was granted May 31, 1938 (R. 132). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS INVOLVED

1. Whether the value of the property received by the petitioner in compromise of his suit to contest his grandmother's will is exempt from income tax as a bequest or inheritance within the meaning of Section 22 (b) (3) of the Revenue Act of 1932.

2. Whether the value of the property thus received constitutes income within the meaning of Section 22 (a) of the Revenue Act of 1932 and the Sixteenth Amendment to the Constitution.

STATUTES AND OTHER AUTHORITIES INVOLVED

The pertinent statutes and other authorities involved will be found in Appendices A and B, *infra*, pp. 70–78.

STATEMENT

This action was instituted against the Collector of Internal Revenue for the refund of an additional assessment of income tax paid for the year 1933. The plaintiff, who is the petitioner in this Court, filed a motion for summary judgment pursuant to Rule 113 of the New York Rules of Civil Practice. The District Court granted the motion (R. 117–118) and entered judgment for the plaintiff in the sum of $65,005.68, plus interest and costs (R. 119). The

Circuit Court of Appeals reversed the judgment of the lower court (R. 129).

The essential facts appear in the pleadings and the opinion of the District Court as follows:

The petitioner is a resident of New York, and is a grandson of Mary B. Longyear, who died March 14, 1931, a resident of Massachusetts, leaving as her heirs four surviving children and the petitioner and his brother, who were sons of a deceased daughter (R. 2–3, 4, 112).

The estate of Mary B. Longyear was initially inventoried at more than $3,000,000 (R. 4, 112).

By a will executed December 7, 1928 (R. 32–39), the decedent bequeathed to the petitioner and his brother each a portrait, a rug, and $5,000; to the four surviving children certain rugs, portraits, and other personalty, and to two of the four children sums of $10,000 and $5,000, respectively. There were a number of other specific bequests, but the entire residuary estate was bequeathed to the trustees of a so-called Endowment Trust created April 5, 1926, the income from which was payable to another set of trustees under another trust known as the Longyear Foundation. The main purpose of the latter trust was to preserve the records of the earthly life of Mary Baker Eddy, the founder of the Christian Science religion (R. 32–39, 64–69, 70–73, 112–113).

The probate of the will was objected to by all of the heirs, who moved in the probate court of Norfolk County, Massachusetts, that issues be framed

for trial by jury to determine whether the decedent was of sound mind at the time of the execution of the will; whether the execution of the will was procured by fraud or undue influence of John V. Dittemore and A. A. Beauchamp, or either of them; and whether the will was procured to be made in whole or in part by the fraud or undue influence of those individuals (R. 44, 53–54, 113).

The probate court after a full hearing directed that issues be framed for submission to a jury (R. 113).[1]

In this situation a settlement was agreed upon and a compromise agreement, dated April 26, 1932, was entered into and signed by the legatees, devisees, executors under the will, the heirs, and the Attorney General of Massachusetts. This agreement provided in substance that the will should be admitted to probate; that the specific and pecuniary bequests to individuals should be enforced; that a specific bequest to charities and the bequest of the residuary estate to the Endowment Trust should be disregarded; that $200,000 should be paid to the heirs and a like amount to the Endowment Trust and that the net residue of the estate should

[1] The supplemental affidavit of George B. Schoonmaker, Assistant United States Attorney, in opposition to the motion for summary judgment, shows that the proponents of the will stated at the hearing that there were prior wills going back to 1920, all of which expressed the same general purpose of making small gifts to her children and leaving the balance to the Christian Science trust which she had conceived of in 1917. (R. 110–111.)

be divided between the trustees of the Endowment Trust and the heirs. It was provided that the net residue to which the heirs should be entitled should be payable in units of stock of Longyear Estate, Inc., a Delaware corporation, Longyear Corporation, a Delaware corporation, and Longyear Realty Corporation, a Michigan corporation. For that purpose a "unit" was to consist of three shares of stock, one share of each corporation (R. 5–6, 15–32, 113).

The compromise agreement was approved by the probate court, and a decree was entered on April 26, 1932, admitting the will to probate, issuing letters testamentary to the named executors, and directing them "to administer the estate of said deceased in accordance with the terms of said will and said agreement of compromise" (R. 39–40, 113).

The depression was then at its height and the executors had difficulty in finding the necessary funds to discharge the pecuniary legacies, which, under the terms of the compromise agreement, were entitled to priority in payment before there could be any distribution of the residue. The heirs thereupon undertook to finance one-half of the pecuniary legacies and the residuary legatees the other half. For their part of the financing the heirs formed a corporation known as Longyear Heirs, Inc., to which they assigned their respective interests in the estate in exchange for common stock.

Preferred stock in the corporation was issued to the pecuniary legatees (R. 6, 113).

In July 1933 the executors distributed to the petitioner property of the estate consisting of cash in the amount of $61.03 and a certificate of deposit for 358 units under a deposit agreement dated April 20, 1928, with the National Park Bank of New York (now the Chase National Bank of the City of New York), each unit representing one share each of the Longyear Estate, Inc., the Longyear Corporation, and Longyear Realty Corporation. At the request of the petitioner the cash and certificate of deposit were paid over to Longyear Heirs, Inc., as petitioner's assignee (R. 5–6, 114).

The Commissioner valued the petitioner's distributable share at $141,484.03 and treated the whole amount as income for 1933, the year in which it was received. An additional tax of $56,389.65 was assessed, which was paid on October 16, 1936, together with interest of $8,616.03 (R. 3–4, 8–10, 114).

A claim for refund was duly filed November 4, 1936, and was rejected November 19, 1936 (R. 4, 10–14, 15); whereupon this suit was brought against the Collector for recovery of the amount paid (R. 1). In his answers and in his answer to the motion for summary judgment the Collector made affirmative defenses by way of set off and recoupment and by way of estoppel. The amended answer set forth that if the property received by the petitioner under the compromise was exempt

from income tax as a bequest or inheritance, the petitioner nevertheless should be denied recovery of the tax paid on the amount, for the reason that the property in question was not included in the gross estate for Federal estate tax, but was deducted on the theory that it was bequeathed to charitable corporations; that if such property was not a bequest to the charitable corporations, it should not have been deducted from the gross estate and that an additional estate tax in excess of $53,178.50 was due; that the estate had been distributed and the petitioner was liable for the estate tax as a transferee (R. 49–53).

In granting the motion for summary judgment and in entering judgment for the petitioner, the District Court held that the value of the property received under the compromise was not income to the petitioner, and it overruled the affirmative defense (R. 112–117). On appeal the Circuit Court of Appeals reversed the District Court's decision, holding that the amount was income and declining to pass on the affirmative defense (R. 124–129). Judge Augustus N. Hand concurred in a separate opinion (R. 129–131).

SUMMARY OF ARGUMENT

I

The value of the property received by the petitioner in 1933 under the compromise of the will contest was not exempt from income tax under

Section 22 (b) (3) of the Revenue Act of 1932 as "property acquired by bequest, devise, or inheritance * * *."

A

1. Petitioner concedes that he has not received a "bequest." We submit that only property received from a decedent's estate by operation of the laws regulating intestate succession can be an "inheritance," and that here the property was received from the legatees specified in the will and pursuant to a contractual arrangement with them. The property received by petitioner has not passed "from the dead to the living by right of succession." *Lang* v. *Commissioner*, 289 U. S. 109, 112.

2. This conclusion is in accordance with the general doctrines of the various state courts, which regard a contestant like the petitioner as taking contractually from the legatee and not from the testator. They do not consider amounts paid out in settlement as within the ambit of inheritance tax statutes embracing property passing "by will or inheritance," or using similar phrases. The opposite conclusion reached by a small minority of the States may be attributed to a leaning away from the general significance of the words used in the statute in the interests of certain policy considerations.

3. The legislative history of the section, and of a cognate provision, demonstrates that Congress has not referred to property acquired by in-

heritance" in some indefinitely broad sense, to include all dispositions of the property comprised in the decedent's estate, but has used the phrase in a precise legal sense to cover property received by right under the laws governing intestate succession, statutes of descent and distribution. It will not suffice to show a receipt from a legatee, after negotiation, by one who is not privileged to proclaim that he was entitled to the property by virtue of the applicability of the intestacy laws. No significance can be attached to the fact that the distribution to petitioner was ordered by decree of the probate court. This procedure is provided by Massachusetts statute merely to assure that the contract of compromise, of a particularly important nature, will be carried out.

4. Nor can the petitioner's status be improved by the suggestion of a receipt of something "in the nature of" an inheritance. The provision grants an exemption from taxes and must be strictly construed.

B

1. If the use of the words "bequest, devise, or inheritance" does not import a receipt from the decedent, then the provision does not establish its own criteria as to the meaning of those words, and what is a bequest or inheritance must be determined by reference to the state law.

2. The statutes and decisions of Massachusetts clearly establish that the contestant receives his

compromise settlement not from the testator but contractually from the legatee. The title to the property comprised in the decedent's estate devolves by force of the will and is then transferred according to the agreement of compromise.

II

The amount received in settlement of the will contest constituted income within the meaning of Section 22 (a) of the Revenue Act of 1932, which defines "gross income" to include gains derived from "sales, or dealings in property * * * growing out of the ownership or use of or interest in such property," and gains and income "derived from any source whatever." It is also income within the meaning of the Sixteenth Amendment.

The taxpayer received property in consideration of his surrendering and forbearing further to pursue a contest of probate. The transaction may be viewed as a payment in consideration of the surrender by the taxpayer of a property right. Or it may be regarded as a payment made to induce him to refrain from an act detrimental to the legatee in the will. In either case, the property received by petitioner may be taxed as his income.

1. In a broad sense, petitioner's right to contest the will was "property." The negotiations based on that right, and culminating in the compromise, may aptly be designated as "dealings in property," within the meaning of Section 22. The transaction

has been regarded as an exchange of property. *Kearney* v. *Commissioner*, 31 B. T. A. 935.

2. Under Section 111, the gain on the disposition of property is the excess of the amount realized over the basis provided in Section 113. Under Section 113 (a) the basis is cost, with certain exceptions. The only exception that requires consideration is section 113 (a) (5), but that relates exclusively to personal property acquired by specific bequest, by will, or by intestacy. This section has application only to property which was actually part of the decedent's estate and was transmitted by virtue of his will, or under the statutes of descent and distribution to those entitled to succeed him. The basis is cost and the cost is zero, since petitioner's rights cost him nothing.

3. There can be no question but that the gain realized upon an exchange of property for other property of a different kind is taxable under the Sixteenth Amendment.

4. It may be suggested that there was no exchange for the reason that petitioner's claim was of such a contingent and speculative character that it cannot be regarded as representing any capital or property owned by him and surrendered in compromise. But if the consideration for the transfer of property to the petitioner was not itself property, it was the petitioner's promise not to contest the will, and a payment made to induce one to refrain from a course of action that may be detrimental to the payor is income within the meaning of the statute. The statute includes income "from

any source whatever" and reaches pretty much every sort of income subject to the Federal power.

5. Such a payment also constitutes a gain from capital or labor, or from both combined, and, therefore, falls within the definition of income in *Eisner* v. *Macomber*, 252 U. S. 189. It has been held that payments made in consideration of a promise not to engage in a competing business are income. The payment in this case is of a similar character. A payment made to induce another not to act or not to use his resources in a certain way has its source in labor or capital, and is a gain derived from either or both of them.

The case is distinguishable from cases holding that a taxpayer does not realize income on a compromise of a suit brought to recover for injury to capital, since in those cases the amount received compensates him for a loss of capital which was the product of expenditures, and the return of which does not constitute income. At best the petitioner had a highly contingent claim to a part of his grandmother's estate, which had cost him nothing, and which he might never have realized. There has been no loss, but a gain which has been realized through the negative use of the petitioner's resources.

6. But if it be held that the definition of income in *Eisner* v. *Macomber* is not broad enough to include payments made to induce one to refrain from acting or from using one's resources, it should nevertheless be held that such payments constitute income under the Sixteenth Amendment, and the

definition in *Eisner* v. *Macomber* should not be considered all-inclusive. Such receipts represent an accretion to economic worth; they may be expended as income without injuring any existing capital, and they serve the purpose of income. They are also not gifts, but are made for a consideration—namely, the promise to forego a course of action that may injure the payor.

ARGUMENT

I

THE PROPERTY RECEIVED BY THE PETITIONER UNDER THE COMPROMISE OF THE WILL CONTEST WAS NOT A BEQUEST OR INHERITANCE AND IS NOT EXEMPT FROM TAX UNDER SECTION 22 (B) (3) OF THE REVENUE ACT OF 1932

Section 22 (b) (3) of the Revenue Act of 1932 (Appendix A, *infra*, p. 71) provides that there shall be excluded from gross income—

> The value of property acquired by gift, bequest, devise, or inheritance * * *.

In the present case the petitioner received a payment in compromise of a contest over the will of his grandmother, Mary B. Longyear, who died in 1931, leaving an estate inventoried at more than $3,000,000. Under her will, executed in 1928, the petitioner would have received only $5,000, a rug and a portrait, the bulk of the estate going to charity, but under the compromise agreement which was approved by the probate court he received in addition property valued at $141,484.03. The sum was neither an amount received under the will nor the

amount which he would have received had there been no will. The property was transferred to him pursuant to the decree of the probate court, which admitted the will to probate, issued letters testamentary to the executors, and directed them "to administer the estate of said deceased in accordance with the terms of said will and said agreement of compromise" (R. 40). The first question is whether the value of the property so transferred is exempt from income tax as a bequest or inheritance within the meaning of Section 22 (b) (3) of the Revenue Act of 1932, *infra*. No contention is made that it was a gift.

A

1. The statute does not define the terms "bequest" and "inheritance," but they are well understood to mean testamentary dispositions. *United States* v. *Merriam*, 263 U. S. 179, 184; see also *Taft* v. *Commissioner*, 304 U. S. 351, 358. From the context it appears that Congress was dealing with testamentary dispositions. The exempting language is "The value of property acquired by gift, bequest, devise, or inheritance * * *." Just as the word "gift" connotes an *inter vivos* transfer, so it is implicit in the words "bequest, devise, or inheritance" that there be a testamentary transfer, either by specific provision of the will or by the operation of the intestacy laws. In this case the decedent's gift to the petitioner consisted exclusively of the $5,000, the rug, and the portrait. That was his bequest. That property has not been

taxed and is not here involved. What is here sought to be taxed did not come from the decedent, but was derived by the petitioner from the other recipients of the decedent's bounty. True, they paid him with property which they received from the decedent, but the payment was nevertheless theirs and not the decedent's. The petitioner received more than the decedent gave him. He received property which the decedent intended that someone else should have. We submit that his bequest is limited to the property which the petitioner received by virtue of the decedent's direction alone. Petitioner concedes that the additional property here involved which he received by separate arrangement with other beneficiaries does not constitute a bequest, but contends that he took it "by inheritance" (Br. 15). We submit that in no proper sense can it be understood as included within either term.

We do not contend, as suggested by Point III of petitioner's brief (pp. 19–22), that the property involved here is income merely because received as a result of a compromise. Nor do we contend, as suggested by petitioner (Br. pp. 28–29), that the avails of every compromise constitute taxable income. Our position is that the receipt of the property by compromise shows that it is not *exempt income;* that is, not a bequest or inheritance. In other words, we say that only property received pursuant to the direction of a decedent can be a bequest; that only property received from a decedent's estate by the operation of the laws of

intestacy can be an inheritance; and that here the property was received pursuant to an arrangement with the legatees and contrary to the directions of the decedent.

The decision of this Court in *Lang* v. *Commissioner*, 289 U. S. 109, fully supports this view. Upon the sale of lands by the survivor of a tenancy by the entirety, the taxpayer contended that the appropriate basis for determining gain or loss was that prescribed for property "acquired by bequest, devise, or inheritance." This Court held the phrase inapplicable, because the wife did not succeed to anything on the death of her husband. Reliance was placed by the taxpayer on *Tyler* v. *United States*, 281 U. S. 497, holding that the tenancy must be included within the husband's gross estate for estate tax purposes. This Court distinguished the *Tyler* case, and stated (p. 112) that it had not decided "that property held by tenants by the entirety *is inherited by the survivor or passes from the dead to the living by right of succession.*" [Italics added.] This is the factor which is wholly lacking in petitioner's case. The $141,484.03 worth of property received by him cannot be said to be property which passed to him from his dead grandmother by right of succession. The property passed from the charity, and by right of the contractual compromise agreement. It cannot be assumed that he had any right of succession to this property.

2. This conclusion is reenforced by reference to the pronouncements of the various courts of the country. Their delineation of the concepts of "be-

quest, devise, or inheritance" are examined not as state law which is controlling (as to which, see *infra*, pp. 27 *et seq.*), but as an indication of the meaning of the federal law. *United States* v. *Merriam*, 263 U. S. 179, 187: "The word 'bequest' having the judicially settled meaning which we have stated, we must presume it was used in that sense by Congress."

The leading decision is *Matter of Cook*, 187 N. Y. 253 (1907), where the widow instituted contest, and in settlement nephews and nieces of the testator assigned to her their residuary legacies. In considering the correct assessment of the state succession tax, the court said (pp. 259–260):

> The compromise did not change the will. No settlement could change a word that the testator wrote. * * * As we said in another case, she [contestant] takes under them [legatees] "by contract, not under the will or from the testator." (*Greenwood* v. *Holbrook*, 111 N. Y. 465, 471.) * * * Here the legatees took the residuum under the will. They succeeded the testator in the ownership thereof and their succession gives rise to the tax. The widow did not take the residue from the testator, for he did not give it to her. She took as assignee, not as legatee. Unless she took as assignee, she did not take at all. The legatees assigned to her and the rate of taxation is fixed by their relation to the testator.

The same underlying doctrine, that the legatee specified takes under the will and the compromis-

ing contestant derives his rights not from the testator but contractually from the legatee, constitutes the basis of decision in similar cases arising in other States, several of them recently. *English* v. *Crenshaw*, 120 Tenn. 531, 547 (1908); *Estate of Wells*, 142 Iowa 255, 263 (1909); *Estate of Graves*, 242 Ill. 212, 217 (1909); *Baxter* v. *Treasurer*, 209 Mass. 459, 462 (1911); *In re Sanford's Estate*, 90 Neb. 410, 416 (1911); *Estate of Rossi*, 161 Cal. 148, 149 (1915); *MacKenzie* v. *Wright*, 31 Ariz. 272, 275 (1927); *Cochran's Executor* v. *Commonwealth*, 241 Ky. 656, 659 (1931); *In re O'Neill*, 111 N. J. Eq. 378, 379–380 (1932); *Lynchburg Bank* v. *Commonwealth*, 162 Va. 73, 82 (1934).[1] Thus, these courts refuse to consider amounts paid out in the settlement as within the ambit of tax statutes, quoted in

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[1] See also *Page* v. *Rives*, Fed. Cas. No. 10666 (C. C. W. D. Va. 1877), where the court upheld the contention that money received on a will compromise was not within the Federal tax covering legacies or distributive shares in intestate estates. But in *McCoy* v. *Gill*, 156 Fed. 985 (C. C. D. Mass. 1907), the court held that unless the United States regarded the estate as passing under the provisions of a compromise under the Massachusetts statute, it could collect nothing under the Act of June 13, 1898, taxing the passing "by will or by the intestate laws of any state."

The foregoing state cases were all concerned with the proper application of inheritance tax statutes, yet their fundamental and underlying theory concerning the nature of the compromise is part of the general jurisprudence of the State. E. g. *Greenwood* v. *Holbrook*, 111 N. Y. 465, 471; *Brandeis* v. *Atkins*, 204 Mass. 471, which interpret the contract with reference to the will, and by the state law governing the testament, respectively, not as a matter of course but in order to effectuate the intention of the contracting parties.

the opinions, embracing property passing "by will or inheritance;"[3] "by will or by the intestate laws";[4] "by will or by laws regulating descents or distributions."[5]

Reference is made by petitioner to an opposite rule in a minority group of five States. Our suggestion concerning the nature of the compromise, as worked out by courts generally, is in no wise weakened by the fact that in Rhode Island there is a statute specifically regarding the will as "modified" by the compromise, which is accordingly deemed part of the will. *Barber* v. *Westcott*, 21 R. I. 355, 356 (1899). The decisions of the other States display such diversity of theory, in holding that the inheritance tax act should be applied as if the amount in compromise was received by will or intestate succession, as to suggest a utilization of an "equitable" construction of these words, contrary to their general significance, in the interests of certain policy considerations.

Thus in Pennsylvania the court discussed the contrary view as inequitable and working a hardship upon the designated legatees, and used the theoretical basis that to the extent of the amount

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[3] Tennessee. The Iowa statute, cited but not quoted in the opinion in the *Wells* case, reads "property * * * which shall pass by will or by the statutes of inheritance." Iowa Code Supp. 1907, sec. 1467, p. 807.

[4] Arizona; Nebraska; also, but not quoted in the opinions, California and New Jersey. See also Massachusetts ("by will or by the laws regulating intestate succession").

[5] Virginia; Illinois ("property descending, whether under the statute of wills or the statute of descent").

paid in compromise the will is a nullity. *Pepper's Estate*, 159 Pa. 608.[6] In Georgia the contestant is considered taxable because but for the laws of descents and distributions the heir would have no basis for contesting the will, and the agreement had the effect of rendering the will inoperative. *Taylor* v. *Georgia*, 40 Ga. App. 295. The Colorado court merely states that the taxpayer took "by virtue of his heirship." *People* v. *Rice*, 40 Colo. 508, 512. The Minnesota court takes what it considers a just and fair view, consistent with every legitimate claim of the State (*In re Estate of Harold Thorson*, 150 Minn. 464, 468). For a justifying theory, it conceives that the legatee must be deemed to have renounced in part (p. 467).[7] Indeed, the opinion originally establishing the construction for Minnesota seized upon the theory that the State, anxious to discourage litigation, should be bound by the decree approving the compromise either as adjudi-

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[6] As to the other cases cited by petitioner, *Avery's Estate*, 34 Pa. St. 204, involved no compromise, but the situation of a widow who had an undisputed right to dower, and whose taking of less was properly regarded by the court as renunciation. *Taber's Estate*, 257 Pa. St. 81, was a case where the Commonwealth would have been entitled to the same tax whether the estate had passed wholly by will or wholly under intestate laws (p. 83). The basis of the decision was wholly pragmatic, that the estate could not take a deduction from the tax, to the prejudice of the Commonwealth, merely because of a private compromise agreement.

[7] The court was apparently untroubled by the fact that the distribution among the contestants was not strictly pursuant to the laws of intestate succession (p. 465) as would have been the case had there been a true renunciation.

citing partial renunciation or "as a construction of the will, even though erroneous." *State* v. *Probate Court*, 143 Minn. 77, 82.

We submit that the efforts of some state courts to adjust the impact of taxing acts do not really establish a doubt as to the general judicial meaning of the words used by Congress in this exempting provision, in which, of course, any doubt would be resolved against the taxpayer.

3. Petitioner advances the suggestion (Br. p. 10) that the statute of descent and distribution was the "proximate cause" of his receiving the property. In view of the applicability of petitioner's argument to moneys received on all will compromises, it may be appropriate to remark, pursuing the analogy from the law of torts, that a compromise agreement establishes merely that the intestacy laws constitute a "but for" cause, and that, as Judge A. N. Hand observed in his concurring opinion, there are reasons apart from the realms of law why will contests are settled.[8]

It may be conceded that the ultimate cause of petitioner's receipt of the property involved was his position as an heir in the event of intestacy.

[8] Thus Judge A. N. Hand referred (R. 130) to the possible desire of the charitable recipient to avoid the expense and annoyance of litigation, or to settle will contests as a matter of policy. Petitioner's arguments would presumably apply where the heirs were contesting a will leaving property to a favored heir, who might well capitulate lest there be "brought to light matters of private life that ought never to be made public," *Smithsonian Institution* v. *Meech*, 169 U. S. 398, 415.

But even as to a person who gives up an indisputable bequest or inheritance and takes other property in exchange, it does not follow that he has received a bequest or inheritance or property with a similar non-taxable status. It must be admitted that a beneficiary would not be exempt if he took other property for his bequest, after receipt. It would also seem that he would not be exempt if an exchange were made prior to the receipt of the bequest.

Where a widow has a choice between a statutory right and the income from a trust fund established by her husband's will, the choice of the latter makes her a beneficiary. *Helvering* v. *Butterworth*, 290 U. S. 365. She is a beneficiary because she chose the trust income, but it does not follow that she would have been a beneficiary if she had insisted upon her statutory right. Her status depends upon what she takes, not upon what she gives up. The new property, not the old, determines her rights and liabilities. Similarly, where a settlement with legatees is availed of in lieu of a claim to a statutory right there is no reason or logic to justify the conclusion that the settlement has not produced taxable income because the statutory right, if it had been established, would not have produced such income.

The fallacy of petitioner's reasoning is clearly seen in the light of the fact that it logically would lead to an exemption where a legatee under a prior

will attacks a subsequent will, and compromises with the beneficiaries under the latter will. Under a logical extension of petitioner's theory the legatee could claim the exemption on the ground that he derived his entire standing to contest and ability to negotiate a compromise from the former will. Yet both the legal content of the crucial words, and their common connotation to laymen, would emphatically require a rejection of the conclusion that the legatee had actually acquired the money by bequest or devise.

Petitioner contends that he took by "inheritance" within the exemption of Sec. 22 (b) (3). Suggestion is made that Congress has used language intending to exempt from income decedent's property transferred under the direction of a probate court (Br. 13), or transferred by every statutory method or general rule of law, the examples given including laws permitting distribution of an estate in accordance with a compromise agreement (Br. 12).

We submit that Congress did not use the word in such an elastic sense. In its strictest legal meaning, and at the old common law, "inheritance" referred only to the descent of estates in land. Black's Law Dictionary (3d ed.) 963; 2 Bouvier's Law Dictionary (3d rev.) 1568; see *Center* v. *Kramer*, 112 Oh. St. 269. In its more modern usage it refers also to the succession to personalty, and indeed was selected by Congress, in preference to the word "de-

scent," on that account.' Its common use in legal parlance today is, broadly, as an alternative to transmittal by will. *Pacheco* v. *Fernandez*, 277 S. W. 197, 198." See e. g. the usage in *Mager* v. *Grima*, 8 How. 490, 493; *Frederickson* v. *Louisiana*, 23 How. 445, 447; *Maxwell* v. *Bugbee*, 250 U. S. 525, 536. In this sense property passing "by inheritance" is commonly used instead of "by intestacy" or "by laws regulating descents or distributions." Thus these expressions seem to be used interchangeably in the various state inheritance taxing acts." And in the Federal income tax statute, the provision now establishing a basis for the disposition of property acquired by "intestacy" is merely the successor, with change in form but not in content in this regard, to a provision referring to property acquired by "inheritance." [12] Section

[9] Section 213 (b) (3) of the Revenue Acts of 1918, 1921, 1924, exempted from income tax property acquired by "bequest, devise, or descent." This was changed to "inheritance" in § 213 (b) (3) of the 1926 Act, which has continued as § 22 (b) (3) of the subsequent Acts, as a word "more appropriately including both real and personal property." S. Rep. No. 52, 69th Cong., 1st Sess., p. 20.

[10] This case also shows that the word may be construed in its popular sense as including property transmitted by will, if that is necessary. Of course, § 22 (b) (3) specifically includes bequests and devises.

[11] Cf. *State ex rel. Pettit* v. *Probate Court*, 137 Minn. 238, 240. See *supra*, footnotes 3 to 5.

[12] Section 204 (a) (5) of the 1926 Act provided that property "acquired by bequest, devise, or inheritance" should have as a basis fair market value at the time of such acquisition. When the basis was changed, and made more complicated, in

22 (b) (3) is correctly interpreted by the regulations, which provide:[11]

> Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt * * *.

We agree with petitioner (Br. 10 ff.), of course, that the word "inheritance" is not preserved for cases of complete intestacy. But it is not applicable, in a loose sense, to all distributions of a decedent's estate, even under supervision of a probate court. The legislative history just considered, both of the section under discussion and of the cognate basis section, demonstrates that Congress has used the word in a precise sense, and has regarded property acquired "by inheritance" as a phrase identical in meaning with property acquired "by intestacy," or "by the statutes of descent and distribution." The exemption applies only to property received from a decedent, to which the taxpayer was entitled to succeed by virtue of the laws regulating intestate succession. And indeed, even the popular dictionary defines "inheritance," apart from its signification with respect to the transmittal of physical or moral characteristics, as the acquisition of property by one person "as heir

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§ 113 (a) (5) of the 1928 Act and 1932 Act (see *infra*, p. 72), the phraseology of "by intestacy" was substituted, without any suggestion of change in content. S. Rep. No. 960, 70th Cong., 1st Sess., p. 26.

[11] Regulations 77, Art. 83, *infra*, p. 74. The same language was used in Regulations 45, Art. 73, and all subsequent regulations.

to another."[1] It will not suffice to show a receipt from a legatee, after negotiation, by one who is not privileged to proclaim that he was entitled to the property by virtue of the applicability of the intestacy laws. See 86, U. of Pa. L. Rev. 443, 444.

Petitioner relies on the fact that the property was distributed (1) under a statutory procedure, and (2) under an order of the probate court. It is submitted that these two factors are irrelevant to the question here involved. It was not an ordinary decree which judicially determined that petitioner was entitled to the property by reason of a will or the laws of intestacy; it was a consent decree which gave petitioner no inheritance but rather what the agreement provided. The statute is not a statute of descent and distribution prescribing general rights in a decedent's estate, but is merely a law assuring the more certain enforcement of will settlements, contracts of a particularly important nature, by providing the supervision of a probate court. *Baxter* v. *Treasurer & Receiver General*, 209 Mass. 459, 461, *infra*, pp. 31–32. The parties could have reached the same legal position by entering into a contract of compromise "without the aid and entirely outside of the statute." *Ibid.* Surely, their choice to have their contract enforced under the supervision of the probate court and

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[1] Webster's New International Dictionary, p. 1279: "inheritance. 1. Act of inheriting; in the broadest sense, the acquisition of property, real or personal, movable or immovable, by one person as heir to another; specif., at the common law, the acquisition of a fee simple or fee tail in land."

through a statutory mechanism does not bestow upon them an exemption from tax.

4. Judge Augustus N. Hand, in his concurring opinion, suggested that whatever the taxpayer had before the compromise was entered into (as distinguished from the property received under the compromise) was "of the nature of an inheritance" (R. 130-131), and that if value could have been placed upon those rights as of the date of death only the excess of the value of the property received over such value should be taxed. We shall discuss his theory more fully in Point II of the Argument, but we wish to emphasize that the statute does not exempt something "in the nature of an inheritance." The provision grants an exemption from tax and must be strictly construed. *Bowers* v. *Lawyers Mortgage Co.*, 285 U. S. 182; *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232; *Phipps* v. *Commissioner*, 91 F. (2d) 627 (C. C. A. 10th), certiorari denied, 302 U. S. 742; *Hale* v. *State Board*, 302 U. S. 95; *Cornell* v. *Coyne*, 192 U. S. 418; *Bank of Commerce* v. *Tennessee*, 161 U. S. 134. See also *Helvering* v. *Ind. Life Ins. Co.*, 292 U. S. 371; *Superintendent of Five Civilized Tribes* v. *Commissioner*, 295 U. S. 418.

B

The same conclusion will be reached if, in order to determine whether the petitioner received a bequest or inheritance, recourse is had to local law; that is, to the common law and/or the state statutes of distribution and descent and state rules of property.

¶1. It may be appropriate here briefly to consider the propriety of an inquiry into the local law, such as was undertaken by the court below. The applicable general principles are clearly stated in *Burnet* v. *Harmel*, 287 U. S. 103, 110. State law may control the application of the statute "when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law." But in the absence of language indicating such a purpose, the legislation "is to be interpreted so as to give a uniform application to a nationwide scheme of taxation," and with respect to terms used in the statute, irrespective of their content under state law, "the Act of Congress has its own criteria." See also *Weiss* v. *Weiner*, 279 U. S. 333, 337.

Of the many cases which have explicitly discussed the problem whether state or Federal law is to apply [11] none has been concerned with the exemption provision in question. The cases cited by the petitioner (Br. pp. 17–18) were determined on the basis of criteria found in the Federal taxing statute, with respect to particular questions there involved. They do not furnish any lantern clarifying the exemption provision under consideration here. Clearly state law controls at least to some extent the meaning and effect of wills (*Uterhart* v. *United States*, 240 U. S. 598, 603) and the devolution upon intestacy. The statutory exemption has been held to cover bequests to executors in lieu of compensation (*United States*

[11] They are collected and discussed in Paul, Selected Studies in Federal Taxation (1938), c. 1.

v. *Merriam*, 263 U. S. 179), and the provision according a basis to property acquired by inheritance has been held not to embrace the accession to complete ownership by the survivor of a tenancy by the entirety (*Lang* v. *Commissioner*, 289 U. S. 109), but these decisions, though apparently enunciating rules of nation-wide application, were grounded on general principles of property law of apparently universal acceptance. In *Irwin* v. *Gavit*, 268 U. S. 161, the Court ruled that the exemption provision assumed the gift of a corpus, and did not extend to a bequest of the income from a trust, although apparently the state law regarded the income as the legacy itself (see Mr. Justice Sutherland, dissenting at p. 169). See *Terry* v. *Commissioner*, 26 B. T. A. 1418, 1420, affirmed, 69 F. (2d) 969 (C. C. A. 5th). But *Irwin* v. *Gavit* determined a particular problem according to criteria found in the Act itself, and does not necessarily indicate that similar criteria will be furnished for all questions arising in the application of the provision exempting property acquired by "bequest, devise, or inheritance."

We have discussed above our suggestions that in view of the criteria contained in the exemption provision, and general judicial understanding, the amounts received by petitioner are not exempt. If the use of the words "bequest, devise, or inheritance" does not import a receipt from the decedent, then in our view the taxing statute involved here does not establish its own criteria, and what is a bequest or inheritance must be determined by reference to the state law.

The permissibility of such a reference is supported by the reflection that, like property rights generally, the "right to succeed to the property of the decedent depends upon and is regulated by state law (*Knowlton* v. *Moore*, 178 U. S. 41, 57)," *Uterhart* v. *United States*, *supra*, 603. Just as state law may determine to whom certain items of income flow, where tax liability attaches to ownership (see *Poe* v. *Seaborn*, 282 U. S. 101; *Blair* v. *Commissioner*, 300 U. S. 5), so here it may determine to whom the bequest or inheritance comes. Petitioner objects to the lack of uniformity which will result. But the constitutional requirement of geographic uniformity is not violated because "differences of state law * * * may bring a person within or without the category designated by Congress as taxable," *Poe* v. *Seaborn*, *supra*, 117–118. And if Federal tax statutes do not establish uniform criteria, and on that account produce geographical discriminations which may be regarded as "hard and objectionable or absurd consequences, * * * the remedy lies with the law making authority, and not with the courts." *Crooks* v. *Harrelson*, 282 U. S. 55, 60.

2. Reference to the state law, to the statutes and decisions of Massachusetts, where the estate was administered, clearly establishes that the payment in this case was not received as a bequest or inheritance, and is not exempt under the Federal statute. This view concerning the state law is succinctly expressed in the brief filed by the execu-

tors in the Bureau of Internal Revenue for the purpose of securing a full charitable bequest deduction from the gross estate of petitioner's grandmother (R. 96 *et seq.*).

The procedure which was followed in reaching the compromise was expressly authorized by a Massachusetts statute which has been in effect since 1864. See General Laws of Massachusetts, 1932, Vol. II, Sections 13–18, Appendix B, *infra*, pp. 76–78. The reason for the statute is well stated in *Baxter* v. *Treasurer & Receiver General*, 209 Mass. 459, where the court said (p. 461):

> Before the passage of this earlier statute a contest over the probate of a will could be settled by the parties interested as well as any other suit, provided they were all of age and sui juris; and the courts looked with favor upon such settlements and by proceedings in equity enforced the specific performance of them. *Leach* v. *Fobes*, 11 Gray, 506. But it frequently happened that possible future contingent interests, especially of persons not in being, stood in the way of a settlement because no one was empowered to represent them. There was also some uncertainty about carrying out the settlement even when made by persons competent to contract. If the contestant agreed to withdraw from the contest and allowed the will to be probated upon a promise by the legatees to pay him something, then it might happen that in a suit to enforce the promise

the promisee for some reason might fail to maintain his case even when the promise was in writing. * * *

In this state of the law St. 1864, c. 173, was passed. It did at least three important things. First, it provided the machinery by which any will contest might be settled no matter how complicated might be the provisions of the will as to any possible future contingent interests; second, it made the contract a matter of record, the decree admitting the will to probate specifically stating the terms of the agreement under which the contestants withdraw their opposition, thus conclusively establishing both the form and validity of the agreement; and third, it provided that the terms of the agreement should be carried out, not by the parties themselves, but by the person who should administer the will. * * *

Since the statute a will contest may be settled by the parties when all are competent to contend, without the aid, and entirely outside of the statute, in the same manner as before. * * *

The operation of the statute is succinctly described in *Copeland* v. *Wheelwright*, 230 Mass. 131, where the court said (p. 136):

> The general purpose and effect of this statute has been stated in numerous cases. Most of them are collected in *Ellis* v. *Hunt*, 228 Mass. 39, where the subject is discussed. Its design was, in cases of real controversy between persons claiming as beneficiaries under a will and the heirs at law of the de-

> ceased, to establish a means for settling that controversy and binding future contingent interests, however complicated they may be under the will. The conditions imposed by the statute for such a settlement are that (1) all persons in interest capable of acting for themselves and guardians of those persons in interest ascertained and in being, not competent to act for themselves, shall sign the agreement, (2) a guardian shall be appointed with official responsibility and duty to investigate fully and protect all unascertained and future contingent interests, and (3) the agreement must be found by the court to be just and reasonable in relation to the parties in being and in its effect upon any future contingent interests and bequests to charities, and a decree expressive of that finding must be entered.

Both of the courts below held that the amount received by a contestant under such a compromise is not a bequest or an inheritance under the Massachusetts law and decisions. There is no conflict of decisions in that State as to the nature of the payment received by a contestant through a compromise under which the will is allowed, and the estate is distributed in accordance with the will and the compromise agreement. As the Circuit Court of Appeals stated, it is well-settled that in such a case the contestant takes by purchase from those who get title under the allowed will and in effect make a transfer to him under the settlement contract,

although the transfer may take the form of a direct distribution to the contestant by the executor, as it did here. It was so held in *Ellis* v. *Hunt*, 228 Mass. 39; *Brandeis* v. *Atkins*, 204 Mass. 471; *Baxter* v. *Treasurer & Receiver General*, 209 Mass. 459; *Brown* v. *McLoughlin*, 287 Mass. 15. In the *Baxter* case a testatrix left all but $5 to two nephews, who entered into a compromise giving half of their share to a sister of the testatrix. The court held that the Massachusetts succession tax should be based on the terms of the will unaffected by the compromise agreement. Accord: *Brown* v. *McLoughlin, supra*. In so holding the court said (209 Mass. at 462):

> Under this statute the court does not undertake to admit to probate a part of the will and refuse probate as to another part. The whole will is admitted, but the concessions made by the legatees to the heirs at law or to each other are at the same time noted and made binding upon the parties. But these concessions take effect not because such is the will but because such is the agreement, and whoever takes anything or loses anything by such concessions or changes takes or loses, as the case may be, under the agreement and not under the will.[16]

[16] Petitioner suggests (Br. p. 15) that although the court found that the contestants did not take by will, it neglected to consider whether the property might not have passed to them "by the laws regulating intestate succession." It is plain that the contestants did not take by force of the laws

In *Brandeis* v. *Atkins, supra,* the court referred to provisions in the decree of the probate court similar to those in the decree here involved, and said (p. 474):

> The agreement for compromise did not become a part of the will. Although the practice is to insert a clause in the decree to the effect that the estate shall be administered in accordance with the agreement for compromise established thereby, yet the rights of the parties growing out of the agreement rest upon it and the decree confirming it, and are not testamentary rights. *Blount* v. *Wheeler,* 199 Mass. 330, 339. *Hastings* v. *Nesmith,* 188 Mass. 190. *Abbott* v. *Gaskins,* 181 Mass. 501.

Similarly, in *Ellis* v. *Hunt, supra,* with reference to such compromises, the court said that the rights of the parties, so far as they rested upon the agreement, were "contractual and not testamentary" (p. 43). See also *Forbush* v. *Home for Aged Women,* 241 Mass. 433, 435–436. The title devolves by force of the will and is then transferred according to the agreement of compromise. *Brown* v. *McLoughlin, supra,* p. 17.[17]

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regulating intestate succession, since "upon the probate of the will *the title devolves by force of the will*, and then is transferred according to the agreement of compromise." *Brown* v. *McLoughlin, supra,* 287 Mass. at 17. [Italics added.]

[17] The executors filed the Federal estate tax return on this theory, claiming as a deduction the value of the residuary bequest to a charitable trust in the will as originally written, and the Commissioner accepted that theory (R. 116). The

II

THE AMOUNT RECEIVED IN SETTLEMENT OF THE WILL CONTEST CONSTITUTED INCOME WITHIN THE MEANING OF SECTION 22 (A) OF THE REVENUE ACT OF 1932 AND THE SIXTEENTH AMENDMENT.

Section 22 (a) of the Revenue Act of 1932 (Appendix A, *infra*, p. 70) defines the term "gross income" as "gains, profits, and income" derived from a number of specified sources, including those derived from "sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property," or "gains or profits and income derived from any source whatever." Section 21 defines the term "net income" to mean the gross income computed under Section 22, less the deductions allowed by Section 23.

The taxpayer in this case was the grandson of Mary Beecher Longyear, who under the will of his grandmother was entitled to receive nothing save a portrait, a rug, and $5,000. But the fact that he was an heir gave him the right to contest her will, and if he was successful in overthrowing it and

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Board of Tax Appeals has recently held that that is the proper basis for the deduction where under the local law (in that case, Illinois) the contestants are regarded as taking by purchase under the compromise and not by bequest. See *Continental Illinois National Bank & Trust Co. of Chicago, Executor of Last Will and Testament of Fred B. Jones* v. *Commissioner*, Docket No. 87203, decided July 29, 1938, not yet reported, but found in 1938 C. C. H., Vol. 4, par. 7306. Cf. *Smith* v. *Commissioner*, 78 F. (2d) 897 (C. C. A. 1st), where the local law was otherwise and the deduction was based on compromise.

all previous wills,[18] the grandmother's estate would pass to him and to the other heirs and next of kin, as if she had died intestate. As the court below aptly stated, he was in a bargaining position and in exchange for his promise to drop the will contest and consent to the probate of the will, he in 1933 received property valued at $141,484.03.

What the taxpayer did was to receive property in consideration of his surrendering and forbearing further to pursue a claim which he had by virtue of his position as an heir contestant. The transaction may be considered in two different aspects. In one sense the taxpayer surrendered a "property" right, namely, his cause of action against the probate. In another view, he received a payment made in property to induce him to refrain from an act which would be detrimental to the legatee named in the will. In either case the result is the same, and the property settlement received by petitioner may be taxed as his income.

1. The court below adopted the theory that, when his grandmother died, the petitioner had the right to contest the probate—that he used the bargaining position to obtain property without running any risk, and that as what he relinquished had no cost basis, what he received constituted income, by in-

[18] We make this point because the record shows that there were previous wills of the same general character as the last one, and that under none of them did the heirs take anything substantial (R. 110–111).

creasing whatever he had previously had, to the full extent of its value (R. 127).

Section 22 (a) specifically takes account of income arising from "dealings in property * * *, growing out of the ownership or use of or interest in such property." Petitioner's right to contest the will was "property" in a broad sense, one embracing a chose in action. An apt designation, therefore, of the negotiations based on petitioner's right is "dealings in property." The applicability of Section 22 is readily perceived.

More particularly, the transaction has been regarded as equivalent to an exchange of property. In *Kearney* v. *Commissioner*, 31 B. T. A. 935, the Board of Tax Appeals held that the taxpayer realized income under a compromise of a will contest similar to the compromise here involved. The Board said in part (pp. 937–938):

> However, the petitioner further contends that this payment was not income to him within the meaning of the term "incomes" as used in the Sixteenth Amendment to the Constitution of the United States and, therefore, to tax the receipt of it as if it were income would be unconstitutional. He relies upon the definition of income quoted by the Court in the case of *Eisner* v. *Macomber*, 252 U. S. 189, as follows: "Income may be defined as the gain derived from capital, from labor, or from both combined." The item in controversy would seem to fall within this definition rather than without

> The petitioner apparently had some rights which he asserted or permitted to be asserted on his behalf. Then he gave up these rights in exchange for $23,333.34. The rights cost him nothing and had a basis of zero for gain or loss. Thus, from the assertion and disposition of his rights he derived a gain of $23,333.34. This was a gain derived from capital, from labor, or from both combined. It was income in the ordinary sense of the word and Congress had the power to tax it. Cf. *Lynch* v. *Hornby,* 247 U. S. 339.

2. All gains arising from sales or dealings in property are specifically taxed under Section 22 (a), and all gains upon the exchange of property are recognized, except to the extent that they are specifically excluded under Section 112 (a), *infra,* which is clearly inapplicable to the present case. Section 111 of the statute, *infra,* provides in substance, how to determine the amount of gain realized from the sale or other "disposition" of property, and is obviously applicable to the petitioner's dealings in his cause of action. It provides that the gain shall be the excess of the amount realized from the property over the basis determined as provided in Section 113. Section 113 (a) provides that the basis shall be cost, with thirteen exceptions. The only one of these exceptions which requires any consideration is Section 113 (a) (5), which provides, in part, as follows:

> If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by

> intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. * * *

It is manifest that this subsection is inapplicable. Certainly petitioner did not acquire his status as an heir and his right to contest the will by bequest or devise, nor were his rights acquired by intestacy. He did not acquire his status as an heir from the decedent upon her death. He became her heir at birth. But even if those rights were acquired upon the grandmother's death they were not acquired by "intestacy" within the meaning of the section. This provision, which is obviously *in pari materia* with the exemption from income accorded by Sec. 22 (b) (3), applies only to property which was actually part of the decedent's estate and was transmitted under the statutes of descent and distribution to those entitled to succeed to the decedent's property. *Lang* v. *Commissioner*, 289 U. S. 109. See Point I, *supra*. Hence this exception does not apply, and since it is the only one which conceivably might apply, the basis is cost.

It will be noted that in his concurring opinion Judge Augustus N. Hand held that the gain

equalled the value of the property for the reason that the petitioner had not shown what the rights to contest the will were worth. His statement as to the condition of the record is correct and would support a decision for the Government on the exchange theory, even if the basis were value at the decedent's death. We believe, however, that it would make no difference if the petitioner had shown the value of those rights at the date of death. Since those rights were not acquired *by will or intestacy,* the value at the date of death or at the date of distribution is not the basis. See Section 113 (a) (5), *infra.* Judge Hand's argument to the contrary is due to his having failed to consider the specific language of Section 113 (a) (5), and to his erroneous view that Section 22 (b) (3) should be construed to exempt something which is "of the nature of an inheritance" (R. 130–131), and that the petitioner's right to contest the will was in the nature of an inheritance.

The court below properly held the petitioner taxable on the full value of the property received, and the cost in this case to be zero, since petitioner paid nothing for whatever rights he had at the time of the compromise of the will contest (see *Helvering* v. *Gowran,* 302 U. S. 238). Obviously whatever rights the petitioner acquired he had by operation of law and without any cost whatever. Compare *Sterling* v. *Commissioner,* 93 F. (2d) 304 (C. C. A. 2d), certiorari denied, 303 U. S. 663, in which it was held that money received in satisfaction of a claim to an in-

terest in real estate constituted taxable income in full, for the reason that the claim had no value as of March 1, 1913. There the taxpayer's father had died in 1911, leaving certain real estate to her brother as remainderman, with the income therefrom to go to the brother and to two other annuitants. In 1930, after the death of these three persons, the brother's widow attempted to sell the property and a question arose as to the title. The taxpayer agreed to accept a certain sum for the release of her claim. The court held that the amount received was taxable in full for the reason that the claim apparently had no value on March 1, 1913, or that, if it did have a speculative worth, the taxpayer had not proved its value. As the court below stated in its opinion in this case, it makes no difference that the claim here may have been better founded in law than the claim in the *Sterling* case, since neither had a cost basis. What one receives for his property in excess of its cost is income. *Marine Transport Co.* v. *Commissioner*, 77 F. (2d) 177 (C. C. A. 5th).

In our view, as stated above, Section 113 (a) (5) has application only to property which was actually part of the decedent's estate, and was transmitted by virtue of his will, or under the statutes of descent and distribution to those entitled to succeed him. This section does not authorize an inquiry into the value of petitioner's right as contestant, or into the probability of success of the

attack on the will, for the purpose of substituting some other basis for cost.

It is true that, except to the extent of cost, the value of the right surrendered by petitioner will not be reflected in any reduction of the income realized upon the receipt of the property obtained on account of that surrender. This is not an unfamiliar situation in the tax law. In *Helvering* v. *Butterworth*, 290 U. S. 365, a widow surrendered her statutory rights and accepted bequest of income from a trust established by her husband's will. The Court held that she was taxable as a beneficiary under the statute, and rejected the contention that, to the extent of the value of the statutory rights which she surrendered, the income payments should be treated as a non-taxable return of the purchase price paid for the annuity. "When she makes her election the widow decides to accept the benefits of the will with the accompanying rights and liabilities. In no proper sense does she purchase an annuity" (p. 370).

Again, in *Bull* v. *United States*, 295 U. S. 247, the Court supposed the case of a partner in a firm of ship-brokers, a personal service concern, who assigned his interest to a third person for a valuable consideration. The Court dismissed the possibility that he might be able to characterize as capital his right to share in the profits of the firm. If the partner "in making return of income had valued or capitalized the right to profits which he had thus

sold, had deducted such valuation from the consideration received, and returned the difference only as gain" the Commissioner "would rightly have insisted that the entire amount received was income" (pp. 256–257).

More pertinent here, however, is the case of *United States* v. *Safety Car Heating Co.*, 297 U. S. 88. In that case the taxpayer in 1912 brought suit against another corporation to restrain the infringement of a patent and for an accounting of damages and profits. The suit was pending on March 1, 1913. An interlocutory decree for an injunction was subsequently secured and an accounting followed before a master, who determined that there was due the complainant for profits the sum of $501,180.32, of which $436,137.41 was applicable to the period before March 1, 1913. The District Court confirmed the master's report on October 10, 1923, and a final decree followed in 1924, after the infringing defendant was in the hands of a receiver. While appeals to the Circuit Court of Appeals remained undetermined, the taxpayer in 1925 accepted a settlement of $200,000, which exceeded the expense of the suit by $176,531.95. Of the latter amount $153,621.72 was attributable to acts of infringement before March 1, 1913.

On those facts this Court held that the amount received was taxable in full, rejecting the argument that part was to be excluded because on March 1, 1913, there existed a claim for previous acts of

infringement, which should be regarded as capital. The Court said (pp. 95–96, 97):

> Claims existing unconditionally before March 1, 1913, being thus excluded from the tax, the plain meaning of the regulation is that conditional or contingent claims, though they may have had an inchoate existence before March 1, 1913, are to be taxed when they are shorn of their conditional or contingent quality and become unconditional or absolute. So far as the problem to be solved depends upon the intention of the Congress in the enactment of the statute, the result is hardly doubtful.
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> Whatever obscurity exists has its origin, one may believe, in a not uncommon confusion of the rule with the exception. There is a tendency now and again to look upon March 1, 1913 as fixing a point of time when claims of every kind, no matter how contingent, became transmuted into capital, at least for taxing purposes. This is far from the truth, as the acceptance by Congress of the foregoing regulations sufficiently attests. The intention has rather been that, with exceptions specially declared or dependent upon considerations of established methods of accounting, every form of income accruing fully or unconditionally after February, 1913, shall contribute to the Treasury, though it had a potential existence for years before its capacity to fructify. * * * The case is not helped by speaking of the claim as "property." The question is whether it is property that has been trans-

> muted into capital. In February, 1913, the chose in action now assessed was not a part of the respondent's capital as merchants or other businessmen would understand the term. Cf. *North American Oil Consolidated* v. *Burnet, supra.* At best it was contingent income, the income of the future. It had no inventory value, much less a value quoted in the market. Whether it would ever be worth anything was still unknown and unknowable.' The answer was not given for many years thereafter.

These decisions, particularly the *Bull* and *Safety Car Heating Co.* cases, establish that upon the surrender of certain expectancies and claims in litigation, cost alone is the pertinent basis provided by our tax statutes. When Congress made special provision for property acquired by intestacy, with a basis equal to the "fair market value" at the time of the decedent's death or at the time of distribution, the reference was to actual property formerly part of the decedent's estate and inherited by force of statutes of descent and distribution, and not to a contingent and speculative right to contest a will.

3. If the Court accepts the view that under the compromise the petitioner obtained property in consideration of his surrender of a property right, clearly the gain realized constitutes income within the meaning of the Sixteenth Amendment as well as under the statute.

The term "income" was defined in *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415, and *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, 185, arising under the Corporation Excise Tax Act of 1909, as the "gain derived from capital, from labor, or from both combined." In *Eisner* v. *Macomber*, 252 U. S. 189, 207, a case arising under the Revenue Act of 1916 and the Sixteenth Amendment, this Court accepted that definition, with the proviso that it be understood "to include profit gained through a sale or conversion of capital assets." See also *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509. A gain realized from a conversion of assets by an exchange obviously comes within that definition. See *Marr* v. *United States*, 268 U. S. 536. That gains from exchanges are taxable is taken for granted at the present time. See *Groman* v. *Commissioner*, 302 U. S. 82, 654; *Helvering* v. *Bashford*, 302 U. S. 454. And the surrender of the right to contest, in return for a valuable consideration, if not technically an exchange is a dealing in property sufficiently analogous to an exchange to leave no real doubt of the constitutionality of a tax upon the gain realized therefrom.

It obviously makes no difference that the property surrendered on the exchange has a basis of zero. *Helvering* v. *Gowran*, *supra*. As pointed out heretofore, the basis in this case was zero, for the reason that the surrendered rights cost nothing, and cost, not value, was the prescribed basis under the statute. There was a conversion of assets

through an exchange; the gain arising therefrom is income, whatever be the basis for measuring the gain; and it is not material that the gain taxed equals the value of the property received on the exchange. *Sterling* v. *Commissioner*, *supra*.[19]

Petitioner makes the suggestion (Br. 24) that if the heirs had any property right respecting the estate, they had the right either to the whole estate or to the whole residuary estate; that a compromise agreement therefore cannot be regarded as a sale, conversion, or exchange of assets[20] but is, in its nature a satisfaction. The Government's theory has reference not to any property right of petitioner in his grandmother's estate, as such, but to his right to litigate for part of her estate. Under a technical use of those words there may not have been a sale, conversion, or exchange of this asset, which was never received by the charity as an asset. Yet it was converted into wealth, and in every substantial sense, and for purposes of the

[19] In I. T. 1466, I-2 Cumulative Bulletin 60, it was held that where an heir sold his expectancy before the death of the decedent, he realized a gain equal to the amount received, for the reason that his expectancy cost him nothing.

[20] Petitioner cites *Hale* v. *Helvering*, 85 F. (2d) 819 (D. C. App.). The court held that the compromise of notes at less than face value resulted in an ordinary loss and not a capital loss from the "sale" or "exchange" of the notes. That case was concerned with the construction of a particular section of the Act, and considered the note as the property involved. It did not deny that surrender of the right to sue on the note, as a property right, might yield income within the Sixteenth Amendment, and indeed it did hold that the compromise gave rise to a deductible loss.

Sixteenth Amendment, there was a conversion or exchange [21] of property.

4. However, it might be suggested that there was no exchange because the petitioner's claim was of such a contingent and speculative character that it cannot be considered as representing any capital or property owned by him which he could surrender upon an exchange. While in a loose sense any claim is property, *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, *supra*, pp. 45–46, indicates that a right to sue may be a special kind of "property," such that at least in some circumstances the amount received upon its realization is not identical with a gain arising from a sale or exchange. See also *Helvering* v. *Butterworth*, 290 U. S. 365; *Bull* v. *United States*, 295 U. S. 247, *supra*, pp. 43–44.

Yet if there was no exchange by the petitioner of property for other property, it follows that the legatees who transferred to the petitioner property which came to them under the will (see Point I, *supra*) were also not making an exchange. But they were not transferring the property to the petitioner as a gift, and if the consideration for the transfer was not property, it was the petitioner's promise not to engage in a course of action which might be detrimental to them.

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[21] We are using the word "exchange" to characterize this dealing in property because it is a convenient way of referring to the transaction (see *Kearney* v. *Commissioner*, 31 B. T. A. 935, 938, supra, p. 39), although there may be no exchange in a technical sense. What we say, however, applies equally to a disposition which is not technically an exchange.

It is our position that if there was no exchange, the transaction may properly be regarded as a payment made to induce the petitioner to refrain from the will contest, and that a payment made for such a consideration constitutes gain or profit or income. The payment added to the petitioner's wealth the full value of the property received, and he was free to dispose of it, without disturbing any capital which he had previously. The receipt is taxable under Section 22 (a), which includes gains or profits and income "derived from any source whatever." This was the phrase primarily relied on by the court below. The result exactly fits the definition of income in Article 41 of Regulations 77, *infra*, p. 73, which defines income as "all wealth which flows in to the taxpayer other than as a mere return of capital."

In this connection it is important to remember that this Court has held that the use of this phrase in the various Revenue Acts shows that Congress intended to exert its power to tax to the fullest extent possible and to reach pretty much every sort of income subject to the Federal power. *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 223; *Helvering* v. *Stockholms, &c., Bank*, 293 U. S. 84, 89; *Eisner* v. *Macomber*, 252 U. S. 189; *Irwin* v. *Gavit*, 268 U. S. 161.

5. We submit that on this theory also the receipt was income within the meaning of the Sixteenth Amendment. It is our position that a payment made to induce one to refrain from a course of action which may injure another person or his property is income derived from capital or labor

or both combined within the definition of income in *Eisner* v. *Macomber, supra.* In the alternative, we contend that the definition of income in that case is not all-inclusive and that the payment here is income even though it be held that it was not derived from capital or from labor or from both combined.

There is nothing in *Eisner* v. *Macomber, supra,* that suggests that one may not derive income from a payment made to induce him to change his course of action or to refrain from using his resources in a certain way. The Government may tax gain obtained by a taxpayer by means of the employment in any way, by use or by deliberate non-use, of the sum total of his resources, whether the components thereof relate to his social or official position in life, his connections with members of the family or friends, his special techniques, etc. The gain may be said to be "derived from" his capital (including such resources) and labor combined, within the meaning of *Eisner* v. *Macomber, supra,* if these words are to be viewed broadly. And we think they should be viewed broadly, and indeed must be so viewed in order to embrace that gain which is income within the Sixteenth Amendment because it is viewed as "income" within the ordinary meaning of the term (see *e. g., Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, 364; *United States* v. *Kirby Lumber Co.,* 284 U. S. 1, 3).

A payment made to induce one not to act or not to use one's capital, including the resources by means of which he is able to command the services

of an attorney in connection with his position as an heir of a deceased person, has its source in labor or capital as much as a gain realized through their actual use, and is truly a gain derived from labor or capital or both combined. This reasoning is supported by the decision in *Cox* v. *Helvering,* 71 F. (2d) 987 (App. D. C.), where the court held that a payment received upon an agreement not to enter upon a competing business was income. The Circuit Court of Appeals for the Second Circuit reached the same conclusion in *Salvage* v. *Commissioner,* 76 F. (2d) 112, and its holding was apparently approved by this Court (*Helvering* v. *Salvage,* 297 U. S. 106). To the same effect is *Beals' Estate* v. *Commissioner,* 82 F. (2d) 268 (C. C. A. 2d), in which the court said (p. 270):

> A promise not to work for others or for oneself is no more a conveyance of property than is a promise to enter the promisee's employ. Payment for either promise is income, not proceeds received on disposal of a capital asset. This has already been authoritatively decided. *Salvage* v. *Commissioner,* 76 F. (2d) 112 (C. C. A. 2), affirmed *Helvering* v. *Salvage,* 296 U. S. —, 56 S. Ct. 375, 80 L. Ed. — (January 13, 1936).

In the opinion of the Circuit Court of Appeals in the *Salvage* case it was stated, by way of dicta, that payments made by the Government to farmers to induce them to curtail production of hogs would be income, and the Bureau of Internal Revenue has

consistently held that payments of that character are income. See I. T. 2767, XIII–1, Cumulative Bulletin 35; I. T. 2976, XV–1, Cumulative Bulletin 138; I. T. 2992, XV–2, Cumulative Bulletin 75.

It has been held that graft money received by a public official from a construction company is income (*Chadick* v. *United States*, 77 F. (2d) 961 (C. C. A. 5th), certiorari denied, 296 U. S. 609) and that bribes are income (*United States* v. *Commerford*, 64 F. (2d) 28 (C. C. A. 2d), certiorari denied, 289 U. S. 759).[22] We think it would make no difference whether the graft or the bribe were paid to an official to induce him to act in a certain way or to refrain from acting. A bribe to a policeman to induce him to overlook a violation of a statute would clearly be income in the popular understanding of that term. Equally so, we think, would be a payment received by a blackmailer.[23] In those cases, of course, the payments are made

[22] At one time it was held that embezzled sums did not constitute income. See *Rau* v. *United States*, 260 Fed. 131 (C. C. A. 2d). But that decision was expressly overruled in *National City Bank of New York* v. *Commissioner* (C. C. A. 2d), decided July 11, 1938, not yet officially reported but found in 1938 C. C. H., Vol. 4, par. 9425. See also G. C. M. 16572, XV–1, Cumulative Bulletin 82.

[23] Many other illustrations might be given. For example, a payment made to induce one's neighbor not to rent or sell his house to an objectionable tenant would be income. In the case of *Sabatini* v. *Commissioner* (C. C. A. 2d), decided August 4, 1938, reported in 1938 C. C. H., Vol. 4, par. 9470, it was held that an author realized income by receiving a payment from a publisher for foregoing the right to authorize others to publish his uncopyrighted works.

in illegal transactions, whereas in this case and in the case of the promise not to compete in business they are made to restrain an act which is legal. But we cannot see any basis for a distinction between the two types of cases, and none was made in the *Cox, Salvage,* and *Beals' Estate* cases. We believe that the legal payment is as much income as is the illegal payment. Cf. *United States* v. *Sullivan,* 274 U. S. 259.

At this point it seems appropriate to dispose of the contentions advanced by petitioner under the alleged aegis of *Eisner* v. *Macomber, supra,* and other cases, to show that the compromise yielded no income to him for the reason that there was no gain derived from labor or from capital or from both combined.

There is no merit to the petitioner's suggestion that a transaction must have been entered into for profit to result in income; and he cites no authorities to support that view. Deductions for losses have been so restricted by statute (see Section 23 (e), Revenue Act of 1932), but the term "income" is not limited, by either the statute or the Constitution, to gains realized from transactions entered into for profit. Income may be realized unintentionally and nevertheless be income.

The major argument woven through petitioner's brief is that the amount received under the compromise was a realization of the property inherited from his grandmother, as much so as if his contest had been successful and that this realization was

not income (Br. p. 23). It is argued that if collection of a judgment on a claim would not produce taxable income (here, it would have constituted an inheritance), no gain would result from the satisfaction of the claim by way of compromise (Br. p. 27, pp. 19–22). This apparently was also the theory of the Circuit Court of Appeals for the Fourth Circuit in the case of *Magruder* v. *Segebade*, 94 F. (2d) 177, in which it was held that no income was realized upon the receipt of a cash payment by certain individuals who in consideration of the payment agreed to waive their rights under a prior will which gave them more. The court there said (p. 179):

> The results of a compromise of rights, the proceeds of which rights are not taxable, do not become taxable because the compromise was brought about by an agreement not to litigate.

We submit that the theory of the court in that case is wrong for two reasons. In the first place, it assumes that the question as to what constitutes income should be determined with reference to whether income would have been realized if something else had been done, whereas the courts have repeatedly recognized that a transaction would give rise to income if carried out in one way, while it would not if carried out in another way. See *United States* v. *Phellis*, 257 U. S. 156; *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481; *Clemmons* v. *Commissioner*, 54 F. (2d) 209 (C. C. A. 5th); *Bruce* v.

Helvering, 76 F. (2d) 442 (App. D. C.); *Kennemer* v. *Commissioner*, 96 F. (2d) 177 (C. C. A. 5th). See also *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216; *New Colonial Co.* v. *Helvering*, 292 U. S. 435. That is especially true when the question is whether the transaction produces *exempt* income.

There is, however, a more fundamental difficulty here. There was in this case, on the one hand, a renunciation of a course of action which might, but not positively, have led to a certain result, and, on the other hand, the adoption of a course of action which produced another result. There was not a choice of achieving the same result by different means but a choice of achieving a different result by different means. The petitioner's argument assumes that if he had contested the will or wills he would have been successful, and a share of the property would have come to him; and hence that under the agreement he merely received part of what would have come to him by inheritance. But this argument assumes what can neither be established nor taken to be true. He might have contested the will or wills, the court might have sustained the last will or a prior will as valid, and the petitioner might have received nothing. The most that can be said is that the petitioner had a highly contingent claim to a part of his grandmother's estate. He did not realize a part of his inheritance by compromising this claim, for he had no inheritance; he merely had a possibility of securing an inheritance through litigation, and he bargained

away that possibility. In other words, he forebore further to press a speculative claim to a part of his grandmother's estate, which cost him nothing, and received personal property, which was worth $141,484.03. We submit that he thereby realized a gain from an exchange which constituted income under the statute and under the Sixteenth Amendment.

The cases cited by petitioner do not bear out his suggestion that a compromise can never produce income where the recovery itself would not have been taxed. The main authorities cited by petitioner involved cases in which the plaintiff brought suit to recover for injury to his or its capital. Obviously, when plaintiff compromised the suit for a lesser amount than sufficed to repair the injury to capital, the amount received did not constitute income. But this was true not because of any abstract conceptualistic theory to the effect that a compromise does not yield income where a full recovery would not have been taxable, but because in those cases the amount received on the compromise itself constituted merely a return of capital which is not taxable income.

A detailed analysis of the cases relied upon by the petitioner will more clearly reveal their irrelevance. Thus, in *Strother* v. *Commissioner*, 55 F. (2d) 626 (C. C. A. 4th), affirmed on other grounds, 287 U. S. 314, where the taxpayer received a payment in compromise of his suit to recover the value of coal extracted from his mine by a trespasser, the court sustained his contention that the

money was in effect a return of capital. It pointed out, moreover, that if it had been proved that the amount received was in excess of the allowable depletion, the excess would have been income. Compare *Acme Land & Fur Co.* v. *Commissioner*, 84 F. (2d) 441 (C. C. A. 5th), in which it was held that a taxpayer received income when he was paid a sum by the citizens of New Orleans to reimburse him for a loss from the destruction of wild life caused by the breaking of a levee to protect New Orleans.

In *Farmers & Merchants Bank* v. *Commissioner*, 59 F. (2d) 912 (C. C. A. 6th), where a bank compromised its suit against another bank for damages to its business, the court held that the suit was based upon an injury to the good will of the business; and that an amount paid to compensate one for a loss of good will was not taxable any more than the amount paid as compensation for damages to tangible property.[24] The court clearly implied that if the amount had been paid as a restoration of profits it would have constituted income. The latter conclusion is clearly justified in view of the decision that the owner of a patent realizes income when he compromises and settles his action for profits realized by the infringer. *United States* v. *Safety Car Heating Co.*, 297 U. S. 88. See also

[24] Compare *O'Rear* v. *Commissioner*, 80 F. (2d) 473 (C. C. A. 6th), where it was held that an amount was not received from a disposition of good will but represented anticipated future income, which was taxable.

W. W. Sly Manufacturing Co. v. *Commissioner*, 24 B. T. A. 65.

Similarly, as to *Chicago & N. W. Ry. Co.* v. *Commissioner*, 66 F. (2d) 61 (C. C. A. 7th), certiorari denied, 290 U. S. 672, the moneys received as a compromise, in the suit for undermaintenance of the railway during Federal control, represented restitution of capital assets. Bureau rulings in which it has been held that one does not realize income from amounts received in settlement of claims for damages for personal injuries, for alienation of affection, or for fraud and deceit connected with a suit to annul a marriage, are based upon very much the same principle as the cases dealing with compensation paid for loss of tangible property. Damages for personal injuries compensate for the loss of capital which lies in human ability. See 31 Op. A. G. 304. In the alienation of affections and the marriage annulment cases the person compensated has lost the chance of realizing a stable and satisfactory marriage, which in a sense is capital.

Alimony is not taxed because it is thought that Congress did not intend to tax moneys received by virtue of the wife's general right to support, which attaches to her as an incident to the marriage status. *Gould* v. *Gould*, 245 U. S. 151, 153; *Douglas v. Willcuts*, 296 U. S. 1, 8. The same reasoning would also apply to amounts, also in discharge of the right to support, paid "in settlement of or in lieu of alimony" (Pet. Br. 21), even if the private

arrangements in the cases cited by petitioner, which may well have been intended to constitute a convenient means for the discharge of the husband's full obligation, are regarded as compromises.

It is true that in *Central R. Co.* v. *Commissioner*, 78 F. (2d) 697 (C. C. A. 3d), the court held that a corporation was not taxable on an amount paid in settlement of a suit brought against an officer to recover secret profits realized by a corporation organized and controlled by the officer for business operations adverse to the taxpayer. The court held that the payment was a penalty imposed on the faithless fiduciary; that it did not arise from the capital or labor of the taxpayer; and that it was not income. We believe that that decision is clearly erroneous. The officer in that case had caused the taxpayer corporation to enter into disadvantageous contracts with the corporation he had created, and the taxpayer sought to recover the profits fraudulently earned by that corporation or the damages sustained. Under the reasoning of the court in the *Safety Car Heating Co.* case, the payment made in compromise of the suit was income. See also *Farmers & Merchants Bank* v. *Commissioner, supra; H. Liebes & Co.* v. *Commissioner*, 90 F. (2d) 932 (C. C. A. 9th); *Knowland* v. *Commissioner*, 29 B. T. A. 618; *Davis* v. *Commissioner*, 35 B. T. A. 1001. In any event, the *Central R. Co.* case, *supra*, is distinguishable from the case at bar on the facts. No amount was paid to this taxpayer as a penalty for the charitable

trust's having made fraudulent profits at his expense.

Nor did the petitioner receive an amount to compensate him for a loss of tangible property or intangible property, as in the *Strother, Farmers & Merchants Bank* and *Chicago & N. W. Ry. Co.* cases, *supra*. In these cases the taxpayers had lost actual capital which was the product of expenditures. In this case, there was no destruction of capital. At best the petitioner had a highly contingent claim to a part of his grandmother's estate, which had cost him nothing, and which he might never have realized, even if he contested her wills and sought to prove that she died intestate. There has been no loss, but a gain, which has been realized from the negative use of the petitioner's resources.

The cases relied upon by the petitioner, therefore, do not establish that a payment received for refraining from a course of action which may be detrimental to another is not income derived from capital or labor or both combined within the meaning of this Court's definition in *Eisner* v. *Macomber, supra*. But if the Court should hold that there is no gain from capital or labor or from both combined, we submit that the payment is nevertheless income under the Sixteenth Amendment.

6. While this Court has often relied upon the definition of income in *Eisner* v. *Macomber, supra*, we cannot find that it has ever said that that definition is all-inclusive. The precise question there

involved was whether a dividend paid to common stockholders in common stock constituted income (see *Koshland* v. *Helvering*, 298 U. S. 441), and this Court held that it did not. In defining income as gain from capital, from labor, or from both combined, this Court stated (p. 207) that that was "the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy." We think that statement suggests that the definition was not all-inclusive.

Furthermore, in this case the payment resulted in an addition to the petitioner's economic worth. This increase in his wealth was in such form that it could be used or disposed of without injuring any capital which he then had. Moreover, he received it for a consideration—namely, his promise to forego a contemplated course of action which might injure the payor. We submit that such a payment is income under the Sixteenth Amendment, even if it should be held not to constitute a gain from labor or capital.

The payment here is to be distinguished from a gift for the reason that it was received for a consideration. *Shellabarger* v. *Commissioner*, 38 F. (2d) 566, 567 (C. C. A. 7th); 1 Page, Contracts (2d Ed., 1920), § 554. Petitioner promised to forego a course of action that might injure the payor. We believe that that fact places it in a different class of receipts and that it may properly be held to be income, whether or not a gift be regarded as income.

But we believe that gifts are not *per se* excluded from income under the Sixteenth Amendment, though they are expressly exempt from tax by statute. The very fact that Section 22 (b) of the Revenue Act of 1932, *infra*, provides that certain items, including the value of gifts, are not to be included in gross income implies that Congress thought that otherwise they might be held to constitute income.[25] See *United States* v. *Oregon-Washington R. & Nav. Co.*, 251 Fed. 211, 214 (C. C. A. 2nd); *Rice* v. *Eisner*, 16 F. (2d) 358 (C. C. A. 2nd), certiorari denied, 273 U. S. 764, and the discussion in Paul and Mertens Law of Federal Income Taxation, Vol. 1, § 5.14, footnote 73. The implication conveyed by the later statute is fortified by an examination of earlier Federal and state legislation. The Act of August 27, 1894, Sec. 28, c. 349, 28 Stat. 509, 553, undertook to levy an income tax on money and the value of all personal property acquired by gift or inheritance. The Revenue Act of 1916, c. 463, 39 Stat. 756, unqualifiedly classified gifts as income. Section 4 of that Act reads:

> SEC. 4. The following *income* shall be exempt from the provisions of this title:
> * * * the value of property acquired by gift * * *. [Italics supplied.]

[25] In *United States* v. *Merriam*, 263 U. S. 179, it was held that a legacy was not income under the statute. Whether it was income within the meaning of the Sixteenth Amendment was not discussed. See also *Burnet* v. *Whitehouse*, 283 U. S. 148.

This language was reenacted in Section 1200 of the Revenue Act of 1917, c. 63, 40 Stat. 300.[26] The taxpayer who receives an accretion to his wealth which he is free to spend has undoubtedly received something which serves the purpose of income. For that reason he has realized income from the point of view of the economists. See Klein, Federal Income Taxation, 13.11; Paul and Mertens, Law of Federal Income Taxation, §§ 5.02–5.06, and footnotes; Magill, When Is Income Realized?; 46 Harvard Law Review 933.

And certainly the payment in this case, and indeed gifts as well, comply with so much of an additional requirement as may be implied from that part of the opinion in *Eisner* v. *Macomber, supra,* p. 207, which refers to "something of exchangeable value * * * *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; * * *."

Gould v. *Gould, supra,* carries no contrary implication. That case held merely that alimony payments made to a divorced wife did not constitute income to her *within the meaning of the Revenue Act.* The case turned entirely on a question of statutory construction and it does not support a

[26] Several state legislatures have similarly evidenced their acceptance of the view that a gift is inherently income. Delaware Laws (1921), Vol. 32, c. 9, Section 3 (a); Revised Statutes of Missouri (1919), Vol. III, c. 119, Art. XIX, Section 13109; Wisconsin Statutes (1925), Vol. 1, Title 10, c. 71, Section 71.05 (1) (g); Virginia Acts of Assembly (1922), c. 463, Section 10 (3) (h).

contention that alimony could not be validly treated as income. In fact the Board of Tax Appeals has held that after the death of the divorced husband alimony payments from a trust which he created are income to the wife. *Elisabeth R. Thomas* v. *Commissioner*, decided December 17, 1937, Memorandum Opinion, unreported, Docket No. 79504.

In *Edwards* v. *Cuba Railroad*, 268 U. S. 628, this Court held that a subsidy paid to a corporation by a foreign State could not be characterized as income on the facts of that case because it represented a contribution to capital. The Court said (pp. 632–633):

> Relying on the contract for partial reimbursement, plaintiff found the money necessary to construct the railroad. The subsidy payments were proportionate to mileage completed; and this indicates a purpose to reimburse plaintiff for capital expenditures. All—the physical properties and the money subsidies—were given for the same purposes. It cannot reasonably be held that one was contribution to capital assets, and that the other was profit, gain, or income.

But such a contribution to capital is not a gift which the recipient is free to spend. Not all subsidies paid by a government are exempt. This Court has held that payments made by the Government to railroads to guarantee their operating income during the period of Federal control are income under the Sixteenth Amendment. *Texas & Pacific Ry. Co.* v. *United States*, 286 U. S. 285;

Continental Tie & L. Co. v. *United States*, 286 U. S. 290. In the former case this Court said (pp. 289-290):

> The sums received under the act were not subsidies or gifts, that is, contributions to the capital of the railroads, and this fact distinguishes cases such as *Edwards* v. *Cuba Railroad Co.*, 268 U. S. 628, where the payments were conditioned upon construction work performed. Here they were to be measured by a deficiency in operating income, and might be used for the payment of dividends, of operating expenses, of capital charges, or for any other purpose within the corporate authority, just as any other operating revenue might be applied. The Government's payments were not in their nature bounties, but an addition to a depleted operating revenue consequent upon a federal activity.

In *Helvering* v. *Claiborne-Annapolis Ferry Co.*, 93 F. (2d) 875 (C. C. A. 4th), it was held that an annual subsidy paid to a ferry company to insure continuous service was income. See also *Burke-Divide Oil Co.* v. *Neal*, 73 F. (2d) 857 (C. C. A. 7th).

The case of *Edwards* v. *Cuba Railroad, supra,* therefore, does not establish that a contribution to a corporation which it is free to use as income does not constitute income under the Sixteenth Amendment. That it may make a difference whether the gift is a contribution to capital, or whether it is an accretion to wealth that the taxpayer is free to spend, is suggested by decisions recognizing that

income may be realized through the release of a fund to income uses. Thus in *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 351–352, it was said, though not necessary to the decision, that if certain reserves set aside in 1912 were excessive and were released to the company and increased its assets in 1913, then the amount of the excess released to the general uses of the company constituted income for 1913.

See also *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, where a corporation was held to realize income by issuing bonds at par and in the same year purchasing some of the bonds back at less than par. "As a result of its dealings it [the taxpayer] made available $137,521.30 assets previously offset by the obligation of bonds now extinct" (p. 3). Income is realized by a lessor when a lessee forfeits its deposit. *Commissioner* v. *Langwell Real Estate Corp.*, 47 F. (2d) 841 (C. C. A. 7th). Excessive fares collected by a railroad are income, when they cannot be returned to those who paid them. *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. (2d) 990 (C. C. A. 7th), certiorari denied, 284 U. S. 618. Such payments are not really income which has been actually earned by labor or capital, but they have nevertheless been held to be income.

We recognize that this Court has held that it is not bound by the theories of economists in determining what is income. *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509; *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216; *Weiss* v. *Wiener*, 279 U. S.

333. But that is not the same thing as saying that a change in economic position is always to be disregarded. Cf. *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, and *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. In the *Midland Ins. Co.* case this Court pointed out (p. 225, footnote 9) that taxability has frequently been determined without reference to factors which the accountant, the economist or the business man might deem relevant to the computation of net gain; citing *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1; *Tyee Realty Co.* v. *Anderson*, 240 U. S. 115; *Weiss* v. *Wiener*, 279 U. S. 333; *Helvering* v. *Ind. Life Ins. Co.*, 292 U. S. 371. But this Court also pointed out that this is partly attributable to the necessity of computing the tax on an annual basis. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Brown* v. *Helvering*, 291 U. S. 193; *Spring City Foundry Co.* v. *Commissioner*, 292 U. S. 182. We have seen no case holding that there is no income within the meaning of the Sixteenth Amendment although there has been an accretion to economic worth *and* that accretion has been evidenced by the receipt of specific property separable from the rest of the taxpayer's wealth and free to be used by the taxpayer as he wishes, so that the increase in worth can be said to have been realized. Treating as income a gift or other payment which constitutes an actual accretion to wealth during the taxable year, and which one is free to spend as income without injury to existing capital, presents no difficulties from the standpoint

of the necessity for accounting on an annual basis.

As previously indicated, however, we believe that the compromise in this case produced income within the meaning of the Sixteenth Amendment, whether or not a gift be regarded as income. The transaction involved either an exchange of property rights for property, which resulted in a gain, or a payment made in consideration of the petitioner's promise not to use his resources in contesting the will that might result in injury to the legatees. Upon either theory we submit that the amount which has been taxed was income.

CONCLUSION

For the reasons stated,[27] the decision of the court below should be affirmed.

Respectfully submitted.

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OCTOBER 1938.

[27] In view of the unsatisfactory nature of the pleadings on this point, we have determined not to press in this Court our equitable defenses based on the non-payment of an estate tax.

APPENDIX A

Constitution of the United States:

AMENDMENT XVI

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) *General Definitions.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * *

(*b*) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, Bequests, and Devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b), and the loss shall be the excess of such basis over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property Transmitted at Death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death.

* * * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 41. *Meaning of net income.*—The tax imposed by the Act is upon income. In the computation of the tax various classes of income must be considered:

(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always accurately reflect income, for the Act recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. (See sections 22, 23, and 101 and the articles thereunder.)

(b) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the Act. (See section 22 and the articles thereunder.)

* * * * *

ART. 51. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales

in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens by sections 212–215 and in certain cases for citizens and domestic corporations deriving income from sources within possessions of the United States by section 251. Income may be in the form of cash or of property. As to dividends, whether in cash or in property, see section 115 and articles 621–629.

* * * * *

ART. 83. *Gifts and bequests.*—Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance based on a separation agreement is taxable income. (See article 281.)

ART. 596. *Property transmitted at death.*—In the following cases the basis of property acquired after February 28, 1913, shall be the fair market value of the property at the time of the death of the decedent:

(1) Personal property acquired by specific bequest;

(2) Real property acquired by general or specific devise or by intestacy; and

(3) Property, whether real or personal, in the hands of a decedent's estate, acquired by the estate from the decedent (see article 863).

In all other cases where property was acquired either by will or by intestacy after February 28, 1913, the basis shall be the fair market value of the property at the time of its distribution to the taxpayer.

In the case of property transferred in trust to pay the income for life to or upon

the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. Accordingly, if a person is entitled to personal property under such a trust instrument after the grantor's death and if such property would be deemed to be acquired by bequest, other than by specific bequest, were the trust instrument a will, the basis of the property, if acquired after February 28, 1913, would be its fair market value at the time it was distributed to the taxpayer. In all other cases where a person is entitled to property, whether real or personal, under such a trust instrument after the grantor's death, the basis of the property, if acquired after February 28, 1913, shall be its fair market value at the time of the grantor's death.

If the property was acquired prior to March 1, 1913, the basis shall be determined as provided in section 113 (a) (13) and article 606.

For the purposes of this article, the value of property as appraised for the purpose of the Federal estate tax or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of State inheritance taxes shall be deemed to be its fair market value at the time of the death of the decedent.

APPENDIX B

General Laws of Massachusetts, Tercentenary Edition (1932), Vol. II, c. 204:

SECTION 13. The probate court may authorize an executor, administrator, guardian, conservator, receiver, commissioner or other fiduciary officer appointed by it, or a trustee, to adjust by arbitration or compromise any demand in favor of or against the estate by him represented.

SECTION 14. The supreme judicial court or the probate court may authorize an executor, administrator, guardian, conservator, receiver, commissioner or other fiduciary officer appointed by the probate court, or a trustee, to adjust by arbitration or compromise any controversy or question as to the administration or distribution of the estate in his possession, or as to his accounting therefor, or as to any matter relating to said estate, or as to the construction of a will or trust created by a written instrument, or as to his power and authority thereunder, or as to any controversy growing out of said will or instrument that may arise between him and any other person or the guardian or conservator of any person interested under said will or instrument or in said estate, or between claimants or the guardians or conservators of claimants to said estate, to which arbitration or compromise, in the form of an agreement in writing, such executor, administrator, guardian, conservator, receiver, commissioner or other fiduciary officer or trustee,

and all other persons in being and of full age and not under guardianship, and the guardian or conservator, if any, of all other persons who claim a vested interest in said estate, whose interests will, in the opinion of the court, be affected by the proposed arbitration or compromise, shall be parties. An award or compromise made in writing in such a case, if found by the court to be just and reasonable in its effects upon the interests of minors and persons under guardianship or conservatorship, and upon any future contingent interests in said estate, shall, when approved by the court, be valid and binding upon all such interests and upon the original parties to said agreement, and a decree shall be entered accordingly. If the court finds that any minor or person without legal capacity or under guardianship, or any future contingent interests, may be affected, it may appoint some person or persons to represent such minor or person without legal capacity or under guardianship, or future contingent interests in such controversy, question, administration or account upon such conditions as to costs as it may order.

SECTION 15. The supreme judicial court or the probate court may authorize the persons named as executors in an instrument purporting to be the last will of a person deceased, or the petitioners for administration with such will annexed, to adjust by arbitration or compromise any controversy between the persons who claim as devisees or legatees under such will and the persons entitled to the estate of the deceased under the laws regulating the descent and distribution of intestate estates, to which arbitration or compromise the persons named as executors, or the petitioners for administration with

the will annexed, as the case may be, those claiming as devisees or legatees whose interests will in the opinion of the court be affected by the proposed arbitration or compromise, and those claiming the estate as intestate, shall be parties.

SECTION 16. If the court finds that any future contingent interests which would arise under said will if admitted to probate would be affected by the arbitration or compromise, it shall appoint some person to represent such interests in such controversy, and the court shall have like power as to any bequests made in the will for charitable purposes, if no trustees have been appointed in such will; in both cases with such conditions as to costs as the court orders.

SECTION 17. An award or compromise made in writing in any such case, if found by the court to be just and reasonable in relation to the parties in being and in its effect upon any future contingent interests that might arise under such will and upon any bequests to charities made in the same, shall be valid and binding upon such interests and upon such bequests, as well as upon the interests of all persons in being, but it shall not impair the claims of creditors.

SECTION 18. If a minor or a person under guardianship or conservatorship is a necessary party to an arbitration or compromise under section fifteen, he shall be represented in the proceedings by his guardian or conservator, or by a guardian ad litem appointed by the court, who shall in the name and in behalf of the party he represents, make and receive all proper conveyances and payments necessary to carry into effect any award or compromise sanctioned by the court.

U. S. GOVERNMENT PRINTING OFFICE, 1939

SUPREME COURT OF THE UNITED STATES.

No. 48.—October Term, 1938.

Munro L. Lyeth, Petitioner,
vs.
James J. Hoey, Collector of Internal Revenue for the United States for the Second District of the State of New York.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 5, 1938.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The question presented is whether property received by petitioner from the estate of a decedent in compromise of his claim as an heir is taxable as income under the Revenue Act of 1932.

Petitioner is a grandson of Mary B. Longyear who died in 1931, a resident of Massachusetts, leaving as her heirs four surviving children and the petitioner and his brother, who were sons of a deceased daughter. By her will, the decedent gave to her heirs certain small legacies and the entire residuary estate, amounting to more than $3,000,000, was bequeathed to trustees of a so-called Endowment Trust, created April 5, 1926, the income from which was payable to another set of trustees under another trust described as the Longyear Foundation. The main purpose of the latter trust was to preserve "the records of the earthly life of Mary Baker Eddy," the founder of the Christian Science religion.

When the will was offered for probate in Massachusetts there was objection by the heirs upon the grounds, among others, of lack of testamentary capacity and undue influence. After hearing, at which a statement was made by the respective parties of their proposed evidence, the probate court granted a motion for the framing of issues for trial before a jury. In that situation a compromise agreement was entered into between the heirs, the legatees, the devisees and the executors under the will, and the Attorney General of Massachusetts. This agreement provided that the will should be admitted to probate and letters testamentary issued; that the specific and pecuniary bequests to individuals should be enforced; that the bequest of the residuary estate to the Endowment Trust should be disregarded; that $200,000 should be paid to the heirs

and a like amount to the Endowment Trust, and that the net residue of the estate, as defined, should be equally divided between the trustees of the Endowment Trust and the heirs. The net residue to which the heirs were thus entitled was to be payable in units of stock owned by the decedent in certain corporations, Longyear Estate, Inc., Longyear Corporation and Longyear Realty Corporation, and for that purpose a unit was to consist of three shares, one share of each corporation.

The compromise was approved by the probate court pursuant to a statute of Massachusetts (Mass. Gen. Laws 1932, Chap. 204, Secs. 15-17) and a decree was entered on April 26, 1932, admitting the will to probate, issuing letters testamentary to the executors and directing them "to administer the estate of said deceased in accordance with the terms of said will and said agreement of compromise". Owing to the depression and the necessity of discharging pecuniary legacies amounting to about $300,000, which were entitled to priority in payment before distribution of the residue, the heirs undertook to finance one-half of these legacies and the residuary legatees the other one-half. For this purpose the heirs formed a corporation known as Longyear Heirs, Inc., to which they assigned their interests in the estate in exchange for common stock. Preferred stock was issued to the pecuniary legatees.

In July, 1933, the executors distributed to Longyear Heirs, Inc., as assignee of the petitioner, his distributable share of the estate consisting of $80.17 in cash and a certificate of deposit for 358 units, each unit representing one share of each of the three corporations mentioned in the compromise agreement. The Commissioner of Internal Revenue valued this distributable share at $141,484.03 and treated the whole amount as income for the year 1933 in which it was received. An additional tax of $56,389.65 was assessed which petitioner paid in October, 1936, with interest. Claim for refund was then filed and on its rejection this suit was brought against the collector.

On motion of petitioner the District Court entered a summary judgment in his favor (20 F. Supp. 619) which the Circuit Court of Appeals reversed. 96 F. (2d) 141. Because of a conflict with the decision of the Circuit Court of Appeals of the Fourth Circuit in *Magruder* v. *Sagebade*, 94 F. (2d) 177, certiorari was granted. May 31, 1938.

The Court of Appeals overruled the contentions of petitioner that the property he received was within the statutory exemption

(Section 22(b) (3) of the Revenue Act of 1932) and, further, that the property was not income either under the statute or under the Sixteenth Amendment of the Federal Constitution. As the view of the Court of Appeals upon these questions determined the rights of the parties, it was found unnecessary to discuss certain affirmative defenses set up by the answer of the respondent and these defenses are not pressed in this court.

First.—By Section 22(b) (3) of the Revenue Act of 1932, there is exempted from the income tax—

"The value of property acquired by gift, bequest, devise, or inheritance. . . ".

Whether property received by an heir from the estate of his ancestor is acquired by inheritance, when it is distributed under an agreement settling a contest by the heir of the validity of the decedent's will, is a question upon which state courts have differed. The question has arisen in the application of state laws of taxation. In Massachusetts, the rule is that when a will is admitted to probate under a compromise agreement, the state succession tax is applied to the property "that passes by the terms of the will as written and not as changed by any agreement for compromise". *Baxter* v. *Treasurer*, 209 Mass. 459, 463. Although under the Massachusetts statute relating to compromise[1] it is the practice to insert a clause in the court's decree that the estate is to be administered in accordance with the agreement, "yet the rights of the parties so far as they rest upon the agreement are contractual and not testamentary". *Ellis* v. *Hunt*, 228 Mass. 39, 43. See, also, *Brandeis* v. *Atkins*, 204 Mass. 471, 474; *Copeland* v. *Wheelwright*, 230 Mass. 131, 136. Thus, when a contest was withdrawn under a compromise and the residuary estate was divided equally between the legatee and the heirs, it was held that the tax was properly levied upon the entire residuary legacy and that the administrators with the will annexed had no right to pay out of the share transferred to the heirs one-half of the tax thus collectible from the legatee unless the compromise agreement expressly or impliedly so provided. *Brown* v. *McLoughlin*, 287 Mass. 15, 17. Several States have a similar rule.[2] In other States the amount

[1] Massachusetts General Laws 1932, Chap. 204, Sects. 13-18.

[2] See Matter of Cook, 187 N. Y. 253; English v. Crenshaw, 120 Tenn. 531; Estate of Wells, 142 Iowa 255; Estate of Graves, 242 Ill. 212; Estate of Rossi, 169 Cal. 148; Cochran's Executor v. Commonwealth, 241 Ky. 656; MacKenzie v. Wright, 31 Ariz. 272; In re O'Neill, 111 N. J. Eq. 378; Lynchburg Bank v. Commonwealth, 162 Va. 73.

received by an heir under an agreement compromising a contest of his ancestor's will is considered to be received by virtue of his heirship and is subject to an inheritance tax unless the statute exempts him.[3]

In the instant case, the Court of Appeals applied the Massachusetts rule, holding that whether the property was received by way of inheritance depended "upon the law of the jurisdiction under which this taxpayer received it". We think that this ruling was erroneous. The question as to the construction of the exemption in the federal statute is not determined by local law. We are not concerned with the peculiarities and special incidences of state taxes or with the policies they reflect. Undoubtedly the state law determines what persons are qualified to inherit property within the jurisdiction. *Mager* v. *Grima*, 8 How. 490, 493; *Maxwell* v. *Bugbee*, 250 U. S. 525, 536, 537. The local law determines the right to make a testamentary disposition of such property and the conditions essential to the validity of wills, and the state courts settle their construction. *Uterhart* v. *United States*, 240 U. S. 598, 603. The State establishes the procedure governing the probate of wills and the processes of administration. Petitioner's status as heir was thus determined by the law of Massachusetts. That law also regulated the procedure by which his rights as an heir could be vindicated. The state law authorized its courts to supervise the making of agreements compromising contests by heirs of the validity of an alleged will of their ancestor, in order that such compromises shall be just and reasonable with respect to all persons in interest.[4] But when the contestant is an heir and a valid compromise agreement has been made and there is a distribution to the heir from the decedent's estate accordingly, the question whether what the heir has thus received has been "acquired by inheritance" within the meaning of the federal statute necessarily is a federal question. It is not determined by local characterization.

In dealing with the meaning and application of an act of Congress enacted in the exercise of its plenary power under the Constitution to tax income and to grant exemptions from that tax, it is the will of Congress which controls, and the expression of its

[3] See Pepper's Estate, 159 Pa. 508; Taber's Estate, 257 Pa. 81; Taylor v. Georgia, 40 Ga. App. 295; People v. Rice, 40 Colo. 508; State v. Probate Court, 143 Minn. 77; Estate of Thorson, 150 Minn. 464. Compare Barber v. Westcott, 21 R. I. 355.

[4] See Note 1. Such agreements are "entirely valid outside of the statute". Ellis v. Hunt, 228 Mass. 39, 44.

will, in the absence of language evidencing a different purpose, should be interpreted "so as to give a uniform application to a nationwide scheme of taxation". *Burnet* v. *Harmel*, 287 U. S. 103, 110. Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law. *Burnet* v. *Harmel*, *supra*. See *Burk-Waggoner Association* v. *Hopkins*, 296 U. S. 110, 111, 114; *Weiss* v. *Wiener*, 279 U. S. 344, 356; *Morrissey* v. *Commissioner*, 296 U. S. 344, 356. Compare *Crooks* v. *Harrelson*, 282 U. S. 55, 59; *Poe* v. *Seaborn*, 282 U. S. 101, 109, 110; *Blair* v. *Commissioner*, 300 U. S. 5, 9, 10. There is no such expression or necessary implication in this instance. Whether what an heir receives from the estate of his ancestor through the compromise of his contest of his ancestor's will should be regarded as within the exemption from the federal tax should not be decided in one way in the case of an heir in Pennsylvania or Minnesota and in another way in the case of an heir in Massachusetts or New York,[5] according to the differing views of the state courts. We think that it was the intention of Congress in establishing this exemption to provide a uniform rule.

Second.—In exempting from the income tax the value of property acquired by "bequest, devise, or inheritance", Congress used comprehensive terms embracing all acquisitions in the devolution of a decedent's estate. For the word "descent", as used in the earlier acts,[6] Congress substituted the word "inheritance" in the 1926 act and the subsequent revenue acts as "more appropriately including both real and personal property."[7] Thus the acquisition by succession to a decedent's estate whether real or personal was embraced in the exemption. Further, by the "estate tax", Congress has imposed a tax upon the transfer of the entire net estate of every person dying after September 8, 1916,[8] allowing such exemptions as it sees fit in arriving at the net estate. Congress has not indicated any intention to tax again the value of the property which legatees, devisees or heirs receive from the decedent's estate.

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[5] See Notes 2 and 3.

[6] See Act of October 3, 1913, Chap. 16, Section II, 38 Stat. 167; Revenue Acts of 1918, 1921 and 1924, Section 213 (b) (3).

[7] Revenue Act of 1926, Section 213 (b) (3); Acts of 1928 and 1932, Section 22 (b) (3). Sen. Rep. No. 52, 69th Cong., 1st Sess., p. 20.

[8] Act of September 8, 1916, Chap. 463, Title II, 39 Stat. 777.

Petitioner was concededly an heir of his grandmother under the Massachusetts statute. It was by virtue of that heirship that he opposed probate of her alleged will which constituted an obstacle to the enforcement of his right. Save as heir he had no standing. Seeking to remove that obstacle, he asserted that the will was invalid because of want of testamentary capacity and undue influence. In accordance with local practice, he asked the probate court to frame these issues for a jury trial. It then became necessary for him to satisfy the court that the issues were substantial. Issues are not to be framed unless it appears from statements by counsel of expected evidence or otherwise that there is a "genuine question of fact supported by evidence of such a substantial nature as to afford ground for reasonable expectation of a result favorable to the party requesting the framing of issues". *Briggs* v. *Weston*, 2 N. E. (2d) 466; *Smith* v. *Patterson*, 286 Mass. 356. Petitioner satisfied that condition and the probate court directed the framing of jury issues. It was in that situation, facing a trial of the issue of the validity of the will, that the compromise was made by which the heirs, including the petitioner, were to receive certain portions of the decedent's estate.

There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, because of his standing as an heir and of his claim in that capacity. It does not seem to be questioned that if the contest had been fought to a finish and petitioner had succeeded, the property which he would have received would have been exempt under the federal act. Nor is it questioned that if in any appropriate proceeding, instituted by him as heir, he had recovered judgment for a part of the estate, that part would have been acquired by inheritance within the meaning of the act. We think that the distinction sought to be made between acquisition through such a judgment and acquisition by a compromise agreement in lieu of such a judgment is too formal to be sound, as it disregards the substance of the statutory exemption. It does so, because it disregards the heirship which underlay the compromise, the status which commanded that agreement and was recognized by it. While the will was admitted to probate, the decree also required the distribution of the estate in accordance with the compromise and, so far as the latter provided for distribution to the heirs, it overrode the will. So far as the will became effective under the agreement it was because of the heirs' consent and release and in consideration of the distribution they received

by reason of their being heirs. Respondent agrees that the word "inheritance" as used in the federal statute is not solely applicable to cases of complete intestacy. The portion of the decedent's property which petitioner obtained under the compromise did not come to him through the testator's will. That portion he obtained because of his heirship and to that extent he took in spite of the will and as in case of intestacy. The fact that petitioner received less than the amount of his claim did not alter its nature or the quality of its recognition through the distribution which he did receive.

We are not convinced by the argument that petitioner had but "the expectations" of an heir and realized on a "bargaining position". He was heir in fact. Whether he would receive any property in that capacity depended upon the validity of his ancestor's will and the extent to which it would dispose of his ancestor's estate. When, by compromise and the decree enforcing it, that disposition was limited, what he got from the estate came to him because he was heir, the compromise serving to remove *pro tanto* the impediment to his inheritance. We are of the opinion that the exemption applies.

In this view we find it unnecessary to consider the other questions that have been discussed at the bar.

The judgment of the Circuit Court of Appeals is reversed and that of the District Court is affirmed.

It is so ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.